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INSURANCE MANAGEMENT

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SYLLABI-BOOK MAPPING TABLE

Insurance Management

Syllabi	Mapping in Book
BLOCK I : RISK, REFORMS, REGULATIONS OF INSURANCE	
UNIT I: Risk Interpretations of the term 'risk'- Types of business and personal risks- Significance of risk management function within business organizations.	**Unit 1:** Risk **(Pages 1-19);**
UNIT II: Insurance and Risk Significance of insurance and risk- General structure of the insurance market- Significant aspects of this industry	**Unit 2:** Insurance and Risk **(Pages 20-41);**
UNIT III: Reforms in Indian Insurance Industry Importance of privatization of insurance industry -Problems associated with public insurance enterprises - Relation between insurance and economic growth	**Unit 3:** Reforms in Indian Insurance Industry **(Pages 42-56);**
UNIT IV: Regulations relating to Insurance Accounting and Management Framework for IRDA rules and regulations regarding general insurance investment in the country - Role of financial reporting in managing insurance operations- Significance of determining solvency margins	**Unit 4:** Regulations Relating to Insurance Accounting and Management **(Pages 57-82);**
BLOCK II : LIFE & NON LIFE INSURANCE, FUNCTIONS	
UNIT V: Life Insurance Factors influencing the key functioning of insurance organizations insurable interest - Role of riders in insurance policies	**Unit 5:** Life Insurance **(Pages 83-105);**
UNIT VI: Non-Life Insurance Elements of fire insurance contract and its ancillary features- Significance of marine insurance and its various policies - The role of rural insurance in making people's lives better in rural India	**Unit 6:** Non-Life Insurance **(Pages 106-118);**
UNIT VII: Non-Life Insurance-II Types of Motor Insurance Policies - Critical aspects of aviation industry in the country- Significance of liability insurance in India	**Unit 7:** Non-Life Insurance-II **(Pages 119-132);**
UNIT VIII: Functions and Organization of Insurers Components of the distribution system of life insurance companies in the country - Role of agents in the life insurance sector in India - Important activities carried out in a life insurance organization	**Unit 8:** Functions and Organization of Insurers **(Pages 133-148);**
BLOCK III: PRODUCT DESIGN, INSURANCE UNDER WRITING, CLAIMS	
UNIT IX: Product Design and Development Product development in the life and non-life insurance sectors in India- Role of risk evaluation in the process of insurance product formation- Future trends in the domain of insurance product design and development	**Unit 9:** Product Design and Development **(Pages 149-162);**
UNIT X: Insurance Underwriting Need for insurance underwriting - Factors that affect the activities performed by the underwriter - Steps involved in the process of insurance underwriting	**Unit 10:** Insurance Underwriting **(Pages 163-172);**
UNIT XI: Claims Management Factors affecting the insurance claim management system - Types of documents needed in various types of claims - Meaning of 'Causa Proxima' in insurance claim settlement	**Unit 11:** Claims Management **(Pages 173-183);**

BLOCK IV: INSURANCE PRICING & MARKETING, REINSURANCE

UNIT XII: Insurance Pricing and Marketing

Principles of insurance pricing and marketing - Tools and techniques used in pricing individual life and health insurance

UNIT XIII: Financial Management in Insuarnce Companies and Insuarnce Ombudsman

Importance of financial management in insurance companies- Tools of managing expenses in the insurance companies - Modes used by the insurance companies in channelizing their funds

UNIT XIV: Reinsurance

Reinsurance in the insurance sector- Areas of the application of reinsurance - Information Technology in Insurance- Application of information technology in the insurance sector -Role of insurance companies in insurance security- Contours of the future of insurance in rural areas

CONTENTS

INTRODUCTION

NOTES

Insurance in India has taken galloping stage. It has maximum growth rate of 56.99 percent in 2006 in world after Liechtenstein (61.58%). Recently De-Tariffing since January 1, 2007 have facilitated the insurer to serve the society with quality and lowest cost in the competitive environment. Now insurance is not limited only to life and property risks; it has expanded its scope to insure all the uninsurable risks. It has innovated avenues to manage all the risks attached to business industry, agriculture, transport, banking and credit, health, catastrophe, liability, guarantee and surety bancassurance and corporate governance. It is expected that inn future political parties would parties would go for insurance of the risks involved inn election. However, the present state of insurance has tried to insurance all the risks related to family, society, business, industry and other economic activities. Therefore, the book has included all sorts of innovative insurance products.

This book, Insurance Management, is divided into fourteen units that follow the self-instruction mode with each unit beginning with an Introduction to the unit, followed by an outline of the Objectives. The detailed content is then presented in a simple but structured manner interspersed with Check Your Progress Questions to test the student's understanding of the topic. A Summary along with a list of Key Words and a set of Self- Assessment Questions and Exercises is also provided at the end of each unit for recapitulation

BLOCK-I
RISK, REFORMS, REGULATIONS OF INSURANCE

NOTES

UNIT 1 RISK

Structure

1.1 INTRODUCTION

Human beings are considered the most intelligent creatures on this earth. The thinking power available to human beings is enormous and this has led human beings to define their style of living and distinguish between good and bad situations. The criteria for deciding whether the situation is good or bad depend upon individual's perception. However, one thing is sure that human beings always prefer and strive for happy situations and wants to avoid the adverse ones. Actually, the zeal to be happy always has given birth to the jargon risk.

1.1.1. The concept of risk

People express risk in different ways. To some, it is the chance or possibility of loss; to others, it may be uncertain situations or deviations or what statisticians call dispersions from the expectations. Different authors on the subject have defined risk differently. However, in most of the terminology, the term risk includes exposure to adverse situations. The indeterminateness of outcome is one of the basic criteria to define a risk situation. Also, when the outcome is indeterminate, there is a

NOTES

possibility that some of them may be adverse and therefore need special emphasis. Look at the popular definitions of risk.

According to the dictionary, risk refers to the possibility that something unpleasant or dangerous might happen.

Risk is a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for.

At its most general level, risk is used to describe any situation where there is uncertainty about what outcome will occur. Life is obviously risky.

The degree of risk refers to the likelihood of occurrence of an event. It is a measure of accuracy with which the outcome of a chance event can be predicted.

In most of the risky situations, two elements are commonly found:

- The outcome is uncertain, i.e., there is a possibility that one or other(s) may occur. Therefore, logically, there are at least two possible outcomes for a given situation.
- Out of the possible outcomes, one is unfavourable or not liked by the individual or the analyst.

1.2 INTERPRETATIONS OF THE TERM 'RISK'

Uncertainty is often confused with the risk. Uncertainty refers to a situation where the outcome is not certain or unknown. Uncertainty refers to a state of mind characterized by doubt, based on the lack of knowledge about what will or what will not happen in the future. Uncertainty is said exist in situations where decision makers lack complete knowledge, information or understanding concerning the proposed decision and its possible consequences.

Risk is sometimes defined as an implication of a phenomenon being uncertain that may be wanted or unwanted.

Uncertainty can be perceived as opposite of certainty where you are assured of outcome or what will happen. Accordingly, some weights or probabilities can be assigned into risky situations but uncertainty, the psychological reaction to the absence of knowledge lacks this privilege.

Decision under uncertain situations is very difficult for the decision-maker. It all depends upon the skill, the judgment and of course luck. Uncertainties and their implications need to be understood to be managed properly.

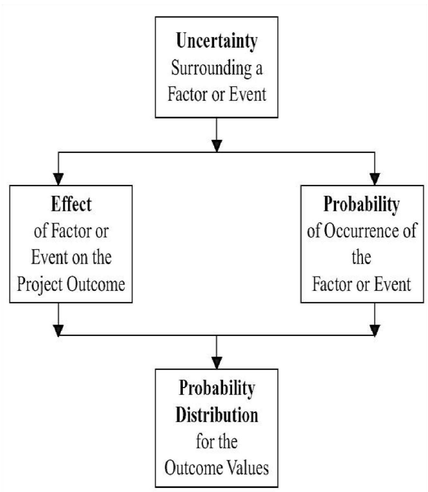


Fig.1.1 Risk

Uncertainty being a perceptual phenomenon implies different degrees to different person. Assume a situation where an individual has to appear for the first in the newly introduced insurance examination.

1. An individual student undergone a training in insurance.
2. An individual with training or experience in insurance.

A's perception towards uncertainty of performance in examination is different from that of B. Nonetheless, in both situations, outcome that is the questions which will be asked in the examination are different.

Uncertainty may be

- **Aleatory uncertainty**: Uncertainty arising from a situation of pure chance, which is known; or
- **Epistemic uncertainty:** Uncertainty arising from a problem situation where the resolution will depend upon the exercise of judgment.

Risk vs. Uncertainty

Risk	**Uncertainty**
Quantifiable	Non-quantifiable
Subjective Probability	Statistical Assessment
Hard Data	Informed Opinion

1.2.1. Loss and chance of loss

A risk refers to a situation where there is the possibility of a loss. What is a loss? Loss has been defined in many ways. Loss, in accounting sense, means that portion of the expired cost for which no compensating value has been received.

NOTES

Loss refers to the Act or instance of losing the detriment or a disadvantage resulting from losing.

Loss means being without something previously possessed.

The chance of loss refers to a fraction or the relative frequency of loss. The chance of loss in insurance sense is the probability of loss.

For example, assume there are 10,000 factories in the insurance pool which may be affected due to earthquake and on the basis of past experience, 5 have been affected, then the probability of loss is 0.0005.

The whole game of insurance business is based on the probability of loss. If the insurer estimates correctly, he wins else loses or is forced to close the business.

From the insurer's perspective, it is the probability of loss that accentuate the need for insurances. The probabilities of losses may be ex-post or ex-ante. In practice, the ex-ante probabilities are widely used for undertaking risk in insurance business.

The chance or probabilities of loss estimation requires accounting for causes of losses popularly characterized as perils and hazards.

1.2.2. Perils

A peril refers to the cause of loss or the contingency that may cause a loss. In literary sense, it means the serious and immediate danger. Perils refer to the immediate causes of loss. Perils may be general or specific, e.g., fire may affect assets like building, automobile, machinery, equipment and also, humans. Collusion may cause damage to the automobile resulting in a financial loss.

1.2.3. Hazards

Hazards are the conditions that increase the severity of loss or the conditions affecting perils. These are the conditions that create or increase the severity of losses. Economic slowdown is a peril that may cause a loss to the business, but it is also a hazard that may cause a heart attack or mental shock to the proprietor of the business. Hazards can be classified as follows:

Physical Hazards

Property conditions - Consists of those physical properties that increase the chance of loss from the various perils. For example, stocking crackers in a packed commercial complex increases the peril of fire.

Intangible Hazards

Attitude Culture- Intangible hazards are more or less psychological in nature. These can be further classified as follows:

NOTES

(a) Moral Hazard

Fraud- These refer to the increase in the possibility or severity of loss emanating from the intention to deceive or cheat. For example, putting fire to a factory running in losses. With an intention to make benefit out of exaggerated claims, deliberately indulging into automobile collusion or damaging it or tendency on part of the doctor to go for unnecessary checks when they are not required, since the loss will be reimbursed by the insurance company.

(b) Morale Hazard

Indifference- It is the attitude of indifference to take care of the property on the premise that the loss will be indemnified by the insurance company. So, it is the carelessness or indifference to a loss because of the existence of insurance contract. For example, smoking in an oil refinery, careless driving, etc.

(c) Societal Hazards

Legal and Cultural - These refer to the increase in the frequency and severity of loss arising from legal doctrines or societal customs and structure. For example, the construction or the possibility of demolition of buildings in unauthorized colonies.

1.3 TYPES OF BUSINESS AND PERSONAL RISKS

Financial risk involves the simultaneous existence of three important elements in a risky situation

- That someone is adversely affected by the happening of an event,
- The assets or income is likely to be exposed to a financial loss from the occurrence of the event and
- The peril can cause the loss. For example, loss occurred in case of damage of property or theft of property or loss of business.

This is financial risk since risk resultant can be measured in financial terms. When the possibility of a financial loss does not exist, the situation can be referred to as non-financial in nature. Financial risks are more particular in nature. For example, risk in the selection of career, risk in the choice of course of study, etc. They may or may not have any financial implications. These types of risk are difficult to measure. As far as insurance is concerned, risk is involved with an element of financial loss.

Individual and Group Risks

A risk is said to be a group risk or fundamental risk if it affects the economy or its participants on a macro basis. These are impersonal in origin and consequence. They affect most of the social segments or the entire population. These risk factors may be socio-economic or political or natural calamities, e.g., earthquakes, floods, wars, unemployment or situations like 11th September attack on US, etc.

NOTES

Individual or particular risks are confined to individual identities or small groups. Thefts, robbery, fire, etc. are risks that are particular in nature. Some of these are insurable. The methods of handling fundamental and particular risks differ by their very nature, e.g., social insurance programmes may be undertaken by the government to handle fundamental risks. Similarly, fire insurance policy may be bought by an individual to prevent against the adverse consequences of fire.

Pure and Speculative Risks

Pure risk situations are those where there is a possibility of loss or no loss. There is no gain to the individual or the organization. For example, a car can meet with an accident or it may not meet with an accident. If an insurance policy is bought for the purpose, then if accident does not occur, there is no gain to the insured. Contrarily, if the accident occurs, the insurance company will indemnify the loss.

Speculative risks are those where there is possibility of gain as well as loss. The element of gain is inherent or structured in such a situation. For example - if you invest in a stock market, you may either gain or lose on stocks.

The distinguishing characteristics of the pure and speculative risks are:

(a) Pure risks are generally insurable while the speculative ones are not.

(b) The conceptual framework of the risk pooling can be applied to pure risks, while in most of the cases of speculative risks it is not possible. However, there may be some situation where the law of mathematical expectation might be useful.

(c) Speculative risk carry some inherent advantages to the economy or the society at large while pure risks like uninsured catastrophes may be highly damaging.

Static and Dynamic Risks

Dynamic risks are those resulting from the changes in the economy or the environment. For example economic variables like inflation, income level, price level, technology changes etc. are dynamic risks. Since the dynamic risk emanates from the economic environment, these are very difficult to anticipate and quantify. Dynamicrisk involves losses mainly concerned with financial losses. These risks affect the public and society. These risks are the best indicators of progress of the society, because they are the results of adjustment in misallocation of resources.

On the other hand, static risks are more or less predictable and are not affected by the economic conditions. Static risk involves losses resulting from the destruction of an asset or changes in its possession as a result of dishonesty or human failure. Such financial losses arise, even if there are no changes in the economic environment. These losses are not useful for the society. These arise with a degree of regularity over time and as a result, are generally predictable. Example for static risk includes possibility of loss in a business: unemployment after undergoing a professional qualification, loss due to act of others, etc.

Dynamic vs. Static Risks

Dynamic Risks	Static Risks
Losses are not easily predictable These risk result from the changes in economic environment These risks are not covered by insurance These risks benefit the society	Losses can be predicted There occur even if there is no change in economic environment These risk can be covered by insurance These risks don't benefit the society

Quantifiable and Non-quantifiable Risks

The risk which can be measured like financial risks are known to be quantifiable while the situations which may result in repercussions like tension or loss of peace are called as non-quantifiable.

1.3.1. Risk for financial institutions

In line with the BASEL accord, the risks for banks, financial institutions, etc. can classified as follows:

Credit Risk

The risk that a customer, counterparty, or supplier will fail to meet its obligations. It includes everything from a borrower default to supplier missing deadlines because of credit problems. Credit risk is the change in value of a debt due to changes in the perceived ability of counterparties to meet their contractual obligations (or credit rating). Also known as default risk or counterparty risk, credit risk is faced by lending institutions like banks, investors in debt instruments of corporate houses, and by parties involved in contractual agreements like forward contracts. There are independent agencies that assess the credit risk in the form of credit ratings.

Credit rating is an opinion (of the credit rating agency) on the ability of the organization to perform its contractual obligations (pay the principle and/or interest of the loan) on a timely basis. Each level of rating indicates a probability of default. International credit rating agencies (like Moody's, Fitch, and S&P) use quantitative models along with their experience to predict the credit ratings. Credit scoring models of banks and lending institutions use stock prices (if available), financial performance and sector-specific data, and macroeconomic forecasts to predict the credit rating.

Credit risk can be further segregated as:

- Direct Credit Risk due to counterparty default on a direct, unilateral extension of credit

NOTES

- Trading credit risk counterparty default on a bilateral obligation (repos)
- Contingent credit risk counterparty default on a possible future extension of credit
- Correlated credit risk magnified effect
- Settlement risk failure of the settlement conditions
- Sovereign risk due to government policies (exchange controls)

Market Risk

The risk that process will move in a way that has negative consequences for a company. Market Risk is the change in value of assets due to changes in the underlying economic factors such as interest rates, foreign exchange rates, macroeconomic variables, stock prices, and commodity prices. All economic entities that own assets face market risk. For example, bills receivable of software exporters that are denominated in foreign currencies are exposed to exchange rate fluctuations; while value of bonds/government securities owned by investors depend on prevailing interest rates. Organizations with huge exposures, either have a dedicated treasury department, or outsource market risk management to banks.

Modeling market risk requires forecasting the changes in the economic factors, and assesses their impact on the asset value. Almost popular measure for expressing market risk is Value-at-Risk, which is 'the maximum loss' from an unfavourable event, within a given level of confidence, for a given holding period. Various financial instruments like options, futures, forwards, swaps, etc. can be used effectively to hedge the market risk. Availability of huge data on various markets has facilitated the development of many sophisticated models.

These risks can be broken into following components:

- Directional Risk deviations due to adverse movement in the direction of the underlying reference asset.
- Curve Risk deviation due to adverse change in the maturity structure of a reference asset.
- Volatility risk unexpected volatility of financial variable.
- Time decay risk due to passage of time.
- Spread risk adverse change in two reference assets that are unrelated.
- Basis risk adverse change in two reference assets that are related
- Correlation risk due to adverse correlations.

Operational

The risk that people, processes, or systems will fail or that an external event will negatively affect the company. Practically speaking, all organizations face operational risk. For a financial institution/bank, operational risk can be defined as the possibility of loss due to mistakes made in carrying out transactions such as

settlement failures, failures to meet regulatory requirements, and untimely collections. No concrete model of managing credit risk is available till today. Still lot of research is being done in this direction.

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Other

Extensions of the above categories, viz., business risk is that future operating results may not meet expectations; organizational risk arises from a badly designed organizational structure or lack of sufficient human resources.

1.3.2. Classifying Pure Risks

Since pure risks are generally insurable, the discussion on risk in further chapters of the book is skewed towards pure risks only. On the presumption that insurable pure risks being static can be classified as follows:



Personal Risks

Personal risks are risks that directly affect an individual. They involve the possibility of the complete loss or reduction of earned income. There are four major personal risks.

Risk of Premature Death

Premature death is defined as the death of the household head with unfulfilled financial obligations. If the surviving family members receive an insufficient amount of replacement income from other sources or have insufficient financial assets to replace the lost income, they may be financially insecure. Premature death can cause financial problems only if the deceased has dependents to support or does with unsatisfied financial obligations. Thus, the death of a child aged 5 is not premature in the economic sense.

Risk of Insufficient Income during Retirement

It refers to the risk of not having sufficient income at the age of retirement or the age becoming so that there is a possibility that individual may not be able to earn the livelihood. When one retires, he loses his earned income. Unless he has sufficient financial assets from which to draw or has access to other sources of retirement income such as social security or a private pension, he will be exposed to financial insecurity during retirement.

Risk of Poor Health

It refers to the risk of poor health or disability of a person to earn the means of survival. For example, losing the legs due to accident, heart surgery that is costly.

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Unless the person has adequate health insurance, private savings or other sources of income to meet these losses, he will be financially insecure. The loss of insecurity is significant if the disability is severe. In case of long-term disability, things will become worst and someone must take care of the disabled person. The loss of earned income can be financially painful.

Risk of Unemployment

The risk of unemployment is another major threat to financial security. Unemployment can result from business cycle downswings, technological and structural changes in the economy, seasonal factors, etc. Employers are increasingly hiring temporary or part-time workers to reduce labor costs. Being temporary employees, workers lose their employee benefits. Unless there is adequate replacement income or past savings on which to draw, the workers (unemployed, part-time and temporary) will be financially insecure. By passage of time, past savings and unemployment benefits may be exhausted.

Property Risks

It refers to the risk of having property damaged or lost because of fire, windstorm, earthquake and numerous other causes. There are two major types of loss associated with the destruction or theft of property.

Direct Loss

A direct loss is defined as a financial loss that results from the physical damage destruction, or theft of the property. For example, physical damage to a factory due to fire is known as direct loss.

Indirect or Consequential Loss

An indirect loss is a financial loss that results indirectly from the occurrence of a direct physical damage or theft loss. For example, in factory, there may be apparent financial losses resulting from not working for several months while the factory was rebuilt and also extra expenses termed as indirect loss. Regardless of the cost, business may lose its customers. In this case, it is necessary to setup a temporary operation at some alternative location and extra expenses would occur. These are the indirect expenses resulting from the damage of the factory.

Liability Risks

These are the risks arising out of the intentional or unintentional injury to the persons or damages to their properties through negligence or carelessness. Liability risks generally arise from the law. For example, the liability of an employer under the workmen's compensation law or other labor laws in India.

In addition to the above categories, risks may also arise due to the failure of others. For example, the financial loss arising from the non-performance or standard performance in an engineering or construction contract.

1.3.3. Risk Perception and Misconceptions

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Different people respond to seemingly similar risky situations in very different ways. It is seen that empirical evidence concerning individual risk response is often ignored in the risk analysis process. Also, experience, subjectivity and the way risk is framed plays a major role in decision-making. Risk perception has a crucial influence on risk-taking behavior. The perceived importance attached to decisions influences team behavior and the consequent implementation methods.

Psychological Risk Dimensions

- **People use heuristics to evaluate information** that may lead to inaccurate judgments in some situations –become cognitive biases.
- **Representativeness** usually employed when people are asked to judge the probability that an object or event belongs to a class or processes by its similarity implying- insensitivity to prior probability, sample size, misconception of chance, insensitivity to predictability, illusion of validity and misconception of regression.
- **Availability heuristic** events that can be more easily brought to mind or imagined are judged to be more likely than events that could not easily be imagined:
    - o Biases due to retrieve ability of instances
    - o Biases due to the effectiveness of research set
    - o Biases of imagine ability
    - o Illusory correlation
- **Anchoring and adjustment heuristic** people will often start with one piece of known information and then adjust it to create an estimate of an unknown risk but the adjustment will usually not be big enough:
    - o Insufficient adjustment
    - o Biases in the evaluation of conjunctive and disjunctive event
    - o Anchoring in the assessment of subjective probability distributions
- **Cognitive Psychology** - Factors that are common and generic are more expressed.
- **Psychometric Paradigm** - People perceive risks to be high in general. Also, perceived risk is quantifiable and predictable. Broad domain of risk characteristics is represented by three high order factors:
    - o The degree to which a risk is understood
    - o The degree to which it evokes a feeling of dread and
    - o The number of people exposed to the risk. Misconceptions of Risk
    - o Risk can be eliminated.

NOTES

- o Risk management is always better.
- o Risk set is finite.
- o Risk management is implied/automatic.
- o Top valued (rated) organizations have best risk management practices.

1.4 SIGNIFICANCE OF RISK MANAGEMENT FUNCTION WITHIN BUSINESS ORGANIZATIONS

Risk management is the process of evaluating the risks faced by a firm or an individual and then minimizing the costs involved with those risks. Any risk entails two types of costs. The first is the cost that will be incurred if a potential loss becomes an actual loss. An example is the cost of rebuilding and reequipping an assembly plant that burns to the ground. The second type consists of the costs of reducing or eliminating the risk of potential loss. Here we would include the cost of purchasing insurance against loss by fire or the cost of not building the plant at all (this cost is equal to the profit that the plant might have earned). These two types of costs must be balanced, one against the other, if risk management is to be effective.

1.4.1. Methods of handling risks

Personal or business or any type of risks are common in the day to day activities; all precautions are to be adopted in protecting ourselves against unforeseen risks. A businessman finds out mean to eliminate the risks or at least minimize the effect of such risks. Burden of risk is the greatest problem in connection with risk management. This is because, it relates to risk of some financial loss. The risk occurs due to multiple causes.

Most people think of risk management as simply buying insurance. However, insurance, although an important part of risk management, is not the only means of dealing with risk. Other methods may be less costly in specific situations. And some kinds of risks are uninsurable not even an insurance company will issue a policy to protect against them. In this section we examine the four general risk-management techniques. The following methods are usually adopted for handling risks.

Risk Avoidance

An individual can avoid the risk of an automobile accident by not riding in a car. A manufacturer can avoid the risk of product failure by refusing to introduce new products. Both would be practicing risk avoidance but at a very high cost. The person who avoids automobile accidents by foregoing cars may have to give up his or her job to do so. The business that does not take a chance on new products probably will fail when the product life cycle, catches up with existing products.

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There are, however, situations in which risk avoidance is a practical technique. At the personal level, individuals who stop smoking or refuse to walk through a dark city park late at night are avoiding risks. Jewelry stores lock their merchandise in vaults at the end of the business day to avoid losses through robbery. And to avoid the risk of a holdup, many gasoline stations accept only credit cards or the exact amount of the purchase for sales made after dark.

Obviously, no person or business can eliminate all risks. By the same token, however, no one should assume that all risks are unavoidable.

Risk Reduction

If a risk cannot be avoided, perhaps it can be reduced. An automobile passenger can reduce the risk of injury in an automobile accident by wearing a seat belt. A manufacturer can reduce the risk of product failure through careful product planning and market testing. In both situations, the cost of reducing risk seems to be well worth the potential saving.

Businesses face risks as a result of their operating procedures and management decision making. An analysis of operating procedures by company personnel or outside consultants often can point out areas in which risk can be reduced. Among the techniques that can be used are

- The establishment of an employee safety program to encourage employees' awareness of safety
- The purchase and use of proper safety equipment, from hand guards on machinery to goggles and safety shoes for individuals
- Burglar alarms, security guards, and even guard dogs to protect warehouses from burglary
- Fire alarms, smoke alarms, and sprinkler systems to reduce the risk of fire and the losses due to fire
- Accurate and effective accounting and financial controls to protect a firm's inventories and cash from pilfering

The risks involved in management decisions can be reduced only through effective decision making. These risks increase when a decision is made hastily or is based on less than sufficient information. However, the cost of reducing these risks goes up when managers take too long to make decisions. Costs also increase when managers require an overabundance of information before they are willing to decide.

Risk Assumption

An individual or firm will and probably must take on certain risks as part of living or doing business. Individuals who drive to work assume the risk of having an accident, but they wear a seat belt to reduce the risk of injury in the event of an accident. The firm that markets a new product assumes the risk of product failure

after first reducing that risk through market testing.

Risk assumption, then, is the act of taking responsibility for the loss or injury that may result from a risk. Generally, it makes sense to assume a risk when one or more of the following conditions exist:

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1. The potential loss is too small to worry about.
2. Effective risk management has reduced the risk.
3. Insurance coverage, if available, is too expensive.
4. There is no other way of protecting against the loss.

Shifting Risks

Perhaps the most common method of dealing with risk is to shift, or transfer, the risk to an insurance company. An insurer is a firm that agrees, for a fee, to assume financial responsibility for losses that may result from a specific risk. The fee charged by an insurance company is called a premium. A contract between an insurer and the person or firm whose risk is assumed is known as an insurance policy. Generally, an insurance policy is written for a period of one year. Then, if both parties are willing, it is renewed each year. It specifies exactly which risks are covered by the agreement, the dollar amounts the insurer will pay in case of a loss, and the amount of the premium.

1.4.2. The risk Management Function

Traditionally, a firm's risk management function ensured that the pure risks of losses were managed appropriately. The risk manager was charged with the responsibility for specific risks only. Most activities involved providing adequate insurance and implementing loss-control techniques so that the firm's employees and property remained safe. Thus, risk managers sought to reduce the firm's costs of pure risks and to initiate safety and disaster management. They also create the risk management guideline for the firm that usually includes the following:

- Writing a mission statement for risk management in the organization
- Communicating with every section of the business to promote safe behavior
- Identifying risk management policy and processes
- Pinpointing all risk exposures (what "keeps employees awake at night")
- Assessing risk management and financing alternatives as well as external conditions in the insurance markets
- Allocating costs
- Negotiating insurance terms
- Adjusting claims adjustment in self-insuring firms
- Keeping accurate records

Writing risk management manuals set up the process of identification, monitoring, assessment, evaluation, and adjustments.

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1.4.3. Importance of Risk Management

Risk management is of vital importance in the day to day business and human activities. It is essential for not only prevention of risks but also for reduction of risks. It provides maximum social advantages. It plays significant role in bringing about social, political and economic development of a country. The importance of risk management is laid down follows:

1. To create the right corporate political and strategy
2. It is essential for effective managing of people and process
3. To evaluate the risks of the business
4. For effective handling of spreading the risk, monitoring and insuring against
5. To introduce various plans and techniques to minimize the risks
6. To give advice and make suggestions about risks among the people
7. To create awareness about risks among the people
8. To avoid cost, disruption and unhappiness in relating to risks
9. To decide which risks are worth pursuing and which should be shunned
10. To fix the sum assured under the policy and to decide on whether to insure or not
11. To select the appropriate technique or methods to manage the risks

1.4.4. The risk Management Process

A typical risk management function includes the steps listed above: identifying risks, assessing them, forecasting future frequency and severity of losses, mitigating risks, finding risk mitigation solutions, creating plans, conducting cost-benefits analyses, and implementing programs for loss control and insurance. For each property risk exposure, for example, the risk manager would adopt the following or similar processes:

- Finding all properties that are exposed to losses (such as real property like land, buildings, and other structures; tangible property like furniture and computers; and intangible personal property like trademarks)
- Evaluating the potential causes of loss that can affect the firms' property, including natural disasters (such as windstorms, floods, and earthquakes); accidental causes (such as fires, explosions, and the collapse of roofs under snow); and many other causes
- Evaluating property value by different methods, such as book value, market value, reproduction cost, and replacement cost
- Evaluating the firm's legal interest in each of the properties whether each property is owned or leased
- Identifying the actual loss exposure in each property using loss histories accounting records, personal inspections, flow charts, and questionnaires

NOTES

- Computing the frequency and severity of losses for each of the property risk exposures based on loss data
- Forecasting future losses for each property risk exposure
- Creating a specific risk map for all property risk exposures based on forecasted frequency and severity
- Developing risk management alternative tools (such as loss-control techniques) based upon cost-benefit analysis or insurance
- Comparing the existing solutions to potential solutions (traditional and nontraditional) uses of risk maps
- Communicating the solutions with the whole organization by creating reporting techniques, feedback, and a path for ongoing execution of the whole process
- The process is very similar to any other business process.

Check Your Progress

1. What are concept of risk
2. Define risk
3. What do you mean by market risk
4. What do you mean by risk management

1.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. People express risk in different ways. To some, it is the chance or possibility of loss; to others, it may be uncertain situations or deviations or what statisticians call dispersions from the expectations. Different authors on the subject have defined risk differently.
2. According to the dictionary, risk refers to the possibility that something unpleasant or dangerous might happen
3. The risk that process will move in a way that has negative consequences for a company. Market Risk is the change in value of assets due to changes in the underlying economic factors such as interest rates, foreign exchange rates, macroeconomic variables, stock prices, and commodity prices. All economic entities that own assets face market risk.
4. Risk management is the process of evaluating the risks faced by a firm or an individual and then minimizing the costs involved with those risks

1.6 SUMMARY

NOTES

In this unit, you have learnt about the risk, loss and chances of loss, perils, hazards, interpretation of risk, types business and personal risk, classifying pure risks, risk perception and misconception, significance of rusk management function and process of the insurance industry.

1.7 KEY WORDS

- **Risk**: To the possibility that something unpleasant or dangerous might happen.
- **Uncertainty**: To a situation where the outcome is not certain or unknown.
- **Loss**: Without something previously possessed.
- **Peril:** To the cause of loss or the contingency that may cause a loss. In literary sense, it means the serious and immediate danger.
- **Hazards:** The conditions that increase the severity of loss or the conditions affecting perils. These are the conditions that create or increase the severity of losses
- **Market Risk:** The risk that process will move in a way that has negative consequences for a company. Market Risk is the change in value of assets due to changes in the underlying economic factors such as interest rates, foreign exchange rates, macroeconomic variables, stock prices, and commodity prices.
- **Risk management:** The steps listed above: identifying risks, assessing them, forecasting future frequency and severity of losses, mitigating risks, finding risk mitigation solutions, creating plans, conducting cost-benefits analyses, and implementing programs for loss control and insurance
- **Personal risks:** Risks that directly affect an individual.

1.8 FURTHER READINGS

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1.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. What is meant by risk
2. Define risk? What are the classification of risks?
3. Distinguish between dynamic risks and static risks?
4. Write explanatory notes on the types of pure risks?
5. What is meant by management of risks?
6. State briefly a suitable definition of insurance
7. What are the principles of insurance
8. What are the difference between risk and uncertainty
9. What do you mean by Hazard
10. What do mean by market risk
11. What are the risk management

Big Questions

1. What is the importance of basic functions?
2. What are the importance of risk management?
3. Write a brief note on risk insurance management process?
4. What do you understand by methods of handling risks?
5. Define risk. List some ways in which risk creates an economic burden for society.
6. Differentiate between the following types of risk: (a) Pure versus speculative (b) Static versus dynamic (c) Subjective versus objective.
7. Give an example of a risk that is both pure and static.

8. An insurable loss is: (a) An event that has not been predicted. (b) An exposure that cannot be easily measured before the event has occurred. (c) An unexpected reduction of economic value. (d) Being without something one has previously possessed.
9. Differentiate between a peril and a hazard and give an example of each.
10. "Pure risks are always insurable." Comment.
11. Distinguish between risk and uncertainty.
12. Enumerate the various psychological dimensions of risk.

UNIT 2 INSURANCE AND RISK

NOTES

Structure

2.1 INTRODUCTION

'Insurance' is a contract between the insurer and the insured under which the insurer undertakes to compensate the insured for the loss arising from the risk insured against. In consideration, the insured agrees to pay a premium regularly. The person whose risk is insured is called 'Insured' or 'Assured'. The person who agrees to compensate the loss arising from the risk is called the 'insurer' or 'Assurer' or 'Underwriter'.

An insurance risk is a threat that is covered by an insurance policy and can cause financial losses. When the insured event takes place and a claim is filed, the insurance company has to pay the policyholder the agreed reimbursement amount.

There are a wide range of events that are considered insurance risks. For example, an auto accident is an auto insurance risk, a policyholder's death is a life insurance risk, and water damage is a homeowner's insurance risk. Insurance premiums are calculated based on the chance that a certain insurance risk will be realized. The greater the chance of the risk occurring, the higher the premiums will tend to be. A driver with a history of accidents or traffic violations, for instance, will be viewed as a higher risk to the insurer and will, therefore, be charged more for auto insurance coverage.

2.1.1. Concept of the term insurance

A contract of insurance is a contract under which the insurer (i.e. insurance company) in consideration of a sum of money paid by the insured (called the premium) agrees.

- To make good the loss suffered by the insured against a specific risk (for which the insurance is effected), such as fire or,
- To pay a pre-fixed amount to the insured or his/her beneficiaries on the happening of specified event e.g. death of the insured.

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2.1.2. Features of insurance

Salient features of the concept of insurance are:

a. Life insurance

It is different from all other types of insurances (i.e. general insurance), in that it is a sort of investment. Under a contract of life insurance, there is a guarantee on the part of the insurance company to pay a fixed amount to the assured (if he is alive) or to his beneficiaries; because death against which insurance is affected is sure to take place sooner or later, i.e. in case of life insurance risk is certain.

All other insurances are contracts of indemnity i.e. the insurance company agrees to make good the loss to the insurance, only when risk (for which insurance is affected) takes place i.e. in other types of insurances, the risk is uncertain.

No claim on the insurance company arises, if the risk does not take place. The latter part (i.e. ii) of the definition given above points out to life insurance; while the former part (i.e. i) points out to other types of insurances.

b. Point of comment

In view of this distinction between the nature of risk in life insurance and other types of insurances, life insurance is technically called life assurance (and not insurance). However, practically the distinction between the terms, insurance and assurance is not observed now-a-days, in that even the Life Insurance Corporation (LIC) uses the term insurance and not assurance as part of its name.

Some Terms in Context of the Term Insurance

Insurer

One who undertakes the responsibility of risks i.e. the insurance company.

Insured

One for whose benefit the insurance is affected i.e. one whose risk is undertaken by the insurance company.

Premium

It is the consideration (i.e. the price) payable by the insured to the insurer, for the responsibility of risk undertaken by the insurer.

Policy

Policy is the document containing terms and conditions of the contract of insurance.

Sum assured

It is the amount for which insurance policy is taken.

Basic Philosophy of Insurance

The basic philosophy of insurance is that it is device for spreading a risk among a number of persons, who are exposed to that risk. For example, let us say that there are 1000 houses in a locality. The owners of all these houses decided to get their houses insured against fire. All the 1000 persons will pay premium to the insurance company, in consideration of the insurance company agreeing to compensate for loss caused by fire. Thus there will be a pool of funds with the insurance company built from premiums paid by all policy-holders. Out of this fund, the insurance company will compensate for loss due to fire caused to those unfortunate ones whose houses are exposed to the risk of fire. It will be a rarity that all houses of the locality are exposed to the risk of fire. Thus insurance is a social device of sharing risks. According to Sir William Beveridge, therefore, "The collective bearing of risk is insurance."

2.2 SIGNIFICANCE OF INSURANCE AND RISK

Insurance has evolved as a process of safeguarding the interest of people from loss and uncertainty. It may be described as a social device to reduce or eliminate risk of loss to life and property.

Insurance contributes a lot to the general economic growth of the society by provides stability to the functioning of process. The insurance industries develop financial institutions and reduce uncertainties by improving financial resources.

We can highlight the significance of insurance, in terms of the following advantages offered by it:

Provide safety and security

Insurance provide financial support and reduce uncertainties in business and human life. It provides safety and security against particular event. There is always a fear of sudden loss. Insurance provides a cover against any sudden loss. For example, in case of life insurance financial assistance is provided to the family of the insured on his death. In case of other insurance security is provided against the loss due to fire, marine, accidents etc.

Generates financial resources

Insurance generate funds by collecting premium. These funds are invested in government securities and stock. These funds are gainfully employed in industrial

development of a country for generating more funds and utilised for the economic development of the country. Employment opportunities are increased by big investments leading to capital formation.

NOTES

Life insurance encourages savings

Insurance does not only protect against risks and uncertainties, but also provides an investment channel too. Life insurance enables systematic savings due to payment of regular premium. Life insurance provides a mode of investment. It develops a habit of saving money by paying premium. The insured get the lump sum amount at the maturity of the contract. Thus life insurance encourages savings.

Promotes economic growth

Insurance generates significant impact on the economy by mobilizing domestic savings. Insurance turn accumulated capital into productive investments. Insurance enables to mitigate loss, financial stability and promotes trade and commerce activities those results into economic growth and development. Thus, insurance plays a crucial role in sustainable growth of an economy.

Medical support

A medical insurance considered essential in managing risk in health. Anyone can be a victim of critical illness unexpectedly. And rising medical expense is of great concern. Medical Insurance is one of the insurance policies that cater for different type of health risks. The insured gets a medical support in case of medical insurance policy.

Spreading of risk

Insurance facilitates spreading of risk from the insured to the insurer. The basic principle of insurance is to spread risk among a large number of people. A large number of persons get insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of funds of the insurer.

Source of collecting funds

Large funds are collected by the way of premium. These funds are utilised in the industrial development of a country, which accelerates the economic growth. Employment opportunities are increased by such big investments. Thus, insurance has become an important source of capital formation.

Concentration on Business Issues

Insurance help businessmen to concentrate their attention on business issues, as their risks are undertaken by the insurance company. Insurance gives them peace of mind. Thus due to insurance, business efficiency increases.

NOTES

Promotion of Foreign Trade

There are many risks in foreign trade much more than involved in home trade. Insurance of risks involved in foreign trade gives a boost to it volume, which is a healthy feature of economic development.

Social Welfare

Life insurance also provides for policies in respect of education of children, marriage of children etc. Such special policies provide a sense of security to the poor who take these policies. Thus life insurance is a device for ensuring social welfare.

Speeding up the Process of Economic Development

Insurance companies mobilize the savings of community through collection of premiums, and invest these savings in productive channels. This process speeds up economic development. Huge funds at the disposal of LIC (Life Insurance Corporation) available for investment purposes support the above-mentioned point of advantage of insurance.

Generation of Employment Opportunities

Insurance companies provide a lot of employment in the economy. This is due to the ever growing business done by insurance companies.

2.2.1. Concepts of double insurance

It is quite possible for a person to take more than one insurance policy to cover the same risk. This is known as double insurance.

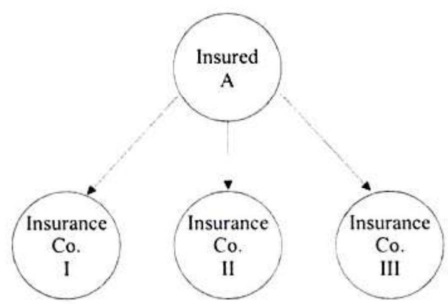


Fig 2.1. Double insurance

In the case depicted above, Mr. A, the insured the has taken three insurance policies for the same subject matter of risk, with three insurance companies -I, II & III.

The implications of double insurance are:

In Case of Life Insurance

In case of life insurance, the insured or his dependents can claim the full amount of policy from each insurance company. This is so because life insurance is a sort of

investment; and a person can take any number of insurance policies on his life and claim full amount under each policy.

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In Case of Other Types of Insurances

In case of fire or marine insurance, the insured cannot recover more than the amount of actual loss from al insurance companies, taken together; because he is not allowed to make any profit out of the transaction of insurance.

Suppose Mr. A insures his house against fire from three insurance companies- I, II & III for Rs.50, 000, 1, 00,000 and 1, 50,000 respectively. His house is destroyed by fire entailing a loss of Rs.60, 000. He can claim in all Rs.60, 000the actual amount of loss in the ratio of 1:2:3 i.e. Rs. 10,000, Rs.20, 000 and Rs.30, 000 from insurance companies I, II and III respectively.

If he claims the full amount of loss i.e. Rs.60, 000 from Insurance Co. II then insurance company II can claim proportionate contribution from Insurance Co. I and III i.e. Rs. 10,000 from Co. I and Rs. 30,000 from Co. III.

Re-insurance

When an insurance company finds that the risk it has undertaken is too heavy for it; it may get itself insured with some other insurance company. This is called re-insurance.

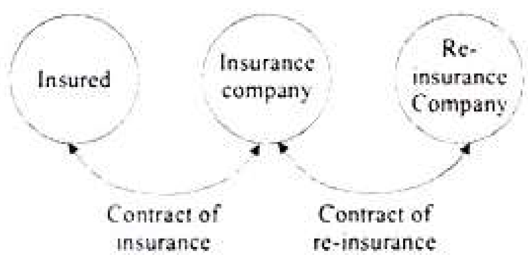


Fig 2.1. Reinsurance

In this case, there are two contracts of insurance:

i. One between the insured and the insurance company called the contact of insurance.
ii. The other between the insurance co. and the re-insurance company called the contact of re-insurance.

The implications of re-insurance are:

1. The insured has no relationship with the re-insurance company. He can claim loss only for the insurance company, with whom he has entered into a contract of insurance.
2. The insurance company can claim loss (paid by it to the insured) from the re-insurance company.

2.3 GENERAL STRUCTURE OF THE INSURANCE MARKET

NOTES

The insurance market has evolved from the establishment of the first automobile insurance policy to the various types of life insurance products that are available today. The insurance market has a structure that involves property and casualty insurers, life insurers as well as health insurers. Each of these types of insurers have regulations that apply to the policies that they provide. Insurers are regulated by a combination of state and federal laws, depending on the type of insurance they offer. The fundamental principles of insurance are the following:

Principle of Utmost Good Faith

A contract of insurance is based on the principle of utmost good faith to be observed by both the parties the insured and the insurance company towards each other. If one party conceals any material information from the other party, which may influence the other party's decision to enter into the contact of insurance; the other party can avoid the contract.

The principle of utmost good faith is equally applicable to both the parties. However, the onus (i.e. burden) of making a full and fair disclosure of all material facts usually rests primarily upon the insured; because the insured is supposed to have an intimate knowledge of the subject-matter of insurance.

The duty of disclosing material facts is not a continuing obligation i .e. the insured is under no obligation to disclosure any material fact which comes to his knowledge after the conclusion of the contract of insurance.

The Principle of Indemnity

Except life insurance, all other contracts of insurance are contacts of indemnity; which means that in the event of the loss caused to the subject matter of insurance, the insured can recovery only the actual amount of loss-subject to a maximum of sum assured.

Suppose A insured his house against fire with an insurance company for Rs. 1, 00,000. The loss caused to the house due to fire is Rs. 80, 000 only. A can recovery only Rs.80, 000 from the insurance company.

The objectives of the principle of indemnity are:

- To put the insured in the same position in which he would have been; had there been no loss.
- Not to allow the insured to make any profit, out of the transaction of insurance.

In case of life insurance, however, it is not possible to estimate the loss caused due to the death of the insured; as life is invaluable. Hence, the full amount of insurance policy can be claimed from the insurance company.

Principle of Insurable Interest

The principle of insurable interest is the foundation of a contract of insurance. In the absence of insurable interest, the contract of insurance is a mere gamble and not enforceable in a court of law.

Insurable interest may be defined as follows:

A person is said to have insurable interest in the subject matter of insurance; when with respect to the subject matter he is so situated that he will benefit from its existence and lose from its destruction.

Insurable interest must exist in life, fire and marine insurances, as per the following rules:

- In case of life insurance; insurable interest must exist at the time of making the contract
- In case of fire insurance; insurable interest must exist both at the time of making the contract and also at the time of loss.
- In case of marine insurance; insurable interest must exist, at the time of loss.

Principle of Contribution

The principle of contribution applies in cases of double-insurance. In case of double insurance, each insurer will contribute to the total payment in proportion to the amount assured by each. In case, one insurer has paid the full amount of loss; he can claim proportionate contribution from other insurers.

Suppose, A insures his house against fire with two insurance companies, X and Y, for Rs.40, 000 and Rs.80, 000 respectively. If the houses catches fire and the actual loss amount to Rs.48, 000, then

X will pay Rs. 16,000 to A

And Y will pay Rs.32, 000 to a

i.e. the loss of Rs.48, 000 is divided between X and Y in the ratio of 40, 000: 80,000 or 1:2.

If X pays the whole loss of Rs.48, 000 to A; it can recover Rs.32, 000 from Y. And if Y pays Rs.48, 000 to A; it can recover Rs. 16,000 from X.

The principle of contribution does not apply to life insurance; where each insurer will pay the full amount of policy to the insured; because life insurance is a sort of investment and life insurance contract is not a contract of indemnity.

Principle of Subrogation

According to the principle of subrogation, after the insurance company has compensated for the loss caused to the insured; the insurance company steps into the shoes of the insured i.e. the insurance company acquires all the rights of the insured, in respect of the damaged property.

Suppose A insures his house for Rs.2, 00,000 against fire. The house is fully damaged by fire and the insurance company pays Rs.2, 00,000 to A. Later on, the damaged house is sold for Rs.25, 000. The insurance company is entitled to receive this sum of Rs.25, 000. Suppose further, it is found that someone tried to put the house on fire.

The insurance company can take action against that person also; because the insurance company acquires all the rights and remedies available to the insured i.e. Mr. A.

Implications of the principle of subrogation are:

- The insurance company gets the rights of the insured, only after compensating for the loss caused to the insured.
- This principle does not apply to life insurance.

Principle of Cause Proxima

According to this principle, we find out which is the proximate cause or the nearest cause of loss to the insured property. If the nearest cause of loss is a factor which is insured against; then only the insurance company is liable to compensate for the loss, otherwise not. This principle is significant in cases when the loss is caused by a series of events.

Suppose X has taken a marine insurance policy against loss or damage to goods caused by sea water. During the voyage rats made a hole in the bottom of the ship, through which sea water seeped into the ship and caused damaged to the goods.

Here, the insurance company is liable to compensate for loss caused to goods; because the proximate cause of loss is sea-water against which insurance is affected. Making of a hole in the bottom of the ship by rats is only the remote cause of loss.

Principle of Mitigation of Loss

According to the principle of mitigation of loss, it is the duty of the insured to take all possible steps to minimize the loss caused to the property covered by the insurance policy. He should behave as a prudent person and must not become careless after taking the insurance policy.

Suppose a house is insured against fire and a fire breaks out. The owner must immediately inform the Fire Brigade department and do each and every thing to extinguish fire; as if the house were not insured. That is, he must make all efforts to minimize the loss caused by fire.

2.3.1. Types of Insurance

Life Insurance

Life insurance is a contract under which the insurance company in consideration of a premium paid in lump sum or periodical installments undertakes to pay a pre-

fixed sum of money on the death of the insured or on his attaining a certain age, whichever is earlier.

Certain important concepts vis-a-vis life insurance

NOTES

Insurable interest

A person can insure a life, in which he has insurable interest. Insurable interest exists in the following cases:

- A person has an unlimited insurable interest in his own life.
- A husband has insurable interest in the life of his wife; and a wife has insurable interest in the life of her husband.
- A father has insurable interest in the life of his son or daughter, on whom he is dependent.
- A son has insurable interest in the life of his parents who support him.
- A creditor has insurable interest in the life of the debtor, to the extent of the debt.

There are many more cases of insurable interest, in case of life insurance, other than those stated above.

Proof of age

In case of life insurance, proof of age is required; because rate of premium depends on age at entry. Proof of age may be given in the form of a school certificate, horoscope, birth certificate from the municipal authority or other legitimate sources.

Nomination

The insured can nominate anyone who will get the amount of policy, in the event of the death of the assured.

Surrender value

Surrender value is the amount which the insurance company would pay to the policy-holder; if he wants to discontinue the policy before the date of its maturity.

Loan on policy

In case, a certain number of premiums has been paid on a life policy; the policy holder may obtain a loan against the policy from the insurance company. The policy holder may pay back the loan within a certain period, or else the loan and interest on it will be adjusted against the payment due on the maturity of the policy.

Health insurance

Health insurance is bought to cover medical costs for expensive treatments. Different types of health insurance policies cover an array of diseases and ailments. You can buy a generic health insurance policy as well as policies for specific diseases. The

premium paid towards a health insurance policy usually covers treatment, hospitalization and medication costs.

Car insurance

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In today's world, a car insurance is an important policy for every car owner. This insurance protects you against any untoward incident like accidents. Some policies also compensate for damages to your car during natural calamities like floods or earthquakes. It also covers third-party liability where you have to pay damages to other vehicle owners.

Education Insurance

The child education insurance is akin to a life insurance policy which has been specially designed as a saving tool. An education insurance can be a great way to provide a lump sum amount of money when your child reaches the age for higher education and gains entry into college (18 years and above). This fund can then be used to pay for your child's higher education expenses. Under this insurance, the child is the life assured or the recipient of the funds, while the parent/legal guardian is the owner of the policy.

Home insurance

We all dreaming of owning our own homes. Home insurance can help with covering loss or damage caused to your home due to accidents like fire and other natural calamities or perils. Home insurance covers other instances like lightning, earthquakes etc.

Fire Insurance

Fire insurance is a contract, under which the insurance company, in consideration of a premium payable by the insured, agrees to indemnify the assured for the loss or damage to the property insured against fire, during a specified period of time and up to an agreed amount.

- In fire insurance, the insurable interest must exist at both the time of contract and the time of loss.
- Fire insurance is a contract of indemnity, and the insured cannot claim more than the amount of actual loss subject to a maximum of the sum assured. Further, the insurance company may compensate in the form of money or in form of replacement or repairs to the property damaged by fire.
- Loss by fire also includes the following losses:
    - o Goods spoiled by water used to extinguish fire
    - o Pulling down of adjacent buildings by Fire Brigade to prevent the progress of flames

- o Breakage of goods in the process of removal from the building where a fire is raging e.g. damage caused by throwing furniture out of the window.
- o Wages paid to workers employed for extinguishing fire.

NOTES

Average clause in fire insurance policy

To take care of the cases of under insurance, there is usually an average clause in a fire policy. According to this clause, in case of loss the insured will himself bear a part of loss. In fact, for the difference between the actual value of the subject matter and the sum assured; the insured has to be his own insurer. Suppose a house worth Rs. 1, 00,000 is insured only for Rs.60, 000 and the insurance policy contains the average clause.

Now, if the loss to the property due to fire is Rs.40, 000 then the insurance company will pay only Rs.24.000 as per the following formula:

$$\frac{\text{Sum assured}}{\text{Valer of property}} \text{ x Claim for actual loss}$$

$$\text{i. e } \frac{60{,}000}{1{,}00{,}000} \text{ x } 40.000 = \text{Rs } 24{,}000$$

Marine Insurance

A contract of marine insurance is a contact under which the insurance company undertakes to indemnify the insured against losses which are incidental to the marine adventure.

The risks, in marine insurance, which are insured against are known as perils of the sea, such as:

1. Storm
2. Collision of one ship against another or against rocks
3. Burning and sinking of the ship
4. Spoilage of cargo by sea-water
5. Jettison i.e. throwing of goods into sea to save the ship from sinking
6. Capture or seizure of the ship
7. Actions of the master or crew of the ship etc.

Types of marine insurance

There are four types of marine insurance, as described below:

Hull insurance

It covers the insurance of the vessel and its equipment's like furniture and fittings, machinery, tools, engine etc.

Cargo insurance

It includes insurance of the cargo or goods contained in the ship and the personal belongings of the crew and the passengers.

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Freight insurance

The shipping company charges some freight for carrying the cargo. Very often there is an agreement between the shipping company and the owners of goods that freight will be paid only when goods reach the destination safely. If the ship is lost on the way or the cargo is stolen or damaged; the shipping company loses the freight. Freight insurance is effected by the shipping company to guard against such risks.

Liability insurance

Under liability insurance, the insurance company undertakes to indemnify against the loss which the insured may suffer on account of liability to a third party. For instance, if one ship collides with another and the first ship is required to pay compensation to the second ship; then this compensation can be claimed from insurance company if liability insurance has been taken.

2.4 SIGNIFICANT ASPECTS OF THIS INDUSTRY

Insurance industry in India has seen a major growth in the last decade along with an introduction of a huge number of advanced products. This has led to a tough competition with a positive and healthy outcome. Insurance sector in India plays a dynamic role in the wellbeing of its economy. It substantially increases the opportunities for savings amongst the individuals, safeguards their future and helps the insurance sector form a massive pool of funds. With the help of these funds, the insurance sector highly contributes to the capital markets, thereby increasing large infrastructure developments in India.

2.4.1. The Indian Insurance Sector

The Indian Insurance Sector is basically divided into two categories: Life Insurance and Non-life Insurance. The Non-life Insurance sector is also termed as General Insurance. Both the Life Insurance and the Non-life Insurance is governed by the IRDAI (Insurance Regulatory and Development Authority of India).

The role of IRDA is to thoroughly monitor the entire insurance sector in India and also act like a custodian of all the insurance consumer rights. This is the reason all the insurers have to abide by the rules and regulations of the IRDAI.

The Insurance sector in India consists of total 57 insurance companies. Out of which 24 companies are the life insurance providers and the remaining 33 are non-life insurers. Out which there are seven public sector companies.

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Life insurance companies offer coverage to the life of the individuals, whereas the non-life insurance companies offer coverage with our day-to-day living like travel, health, our car and bikes, and home insurance. Not only this, but the non-life insurance companies provide coverage for our industrial equipment's as well. Crop insurance for our farmers, gadget insurance for mobiles, pet insurance etc. are some more insurance products being made available by the general insurance companies in India. The life insurance companies have gained an investment prospectus in the recent times with an idea of providing insurance along with a growth of your savings. But, the general insurance companies remain reluctant to offer pure risk cover to the individuals. Let us look at the Performance Highlights of the Indian Insurance Industry:

Strong economic factors and the government pushing the right buttons with the implementation of technology has propelled all sectors of the Indian industry on a glorious path. Life Insurance industry has also made a significant contribution in putting our country on this glorious growth trajectory. Adopting life insurance for risk management and using it as a preferred tool for achieving major life goals has made a noteworthy contribution to the growth of the life insurance industry. Insurance density of life sector has grown to 55 US $ in the year 2017-18, a growth from the previous figure of 46.5 US $ in the year 2016-17. Similarly, Insurance penetration has grown to 2.76% in the year 2017-18 from the previous figure of 2.72% for the year 2016-17.

Life Insurer	Based on % of Policies	Life Insurer	Based on % of Policies
Max Life	98.26%	Canara HSBC OBC Life	95.22%
LIC of India	98.04%	Reliance Nippon Life	95.17%
Tata AIA Life	98.00%	Aviva Life	94.45%
ICICI Prudential Life	97.88%	Kotak Mahindra Life	93.72%
HDFC Standard Life	97.80%	Future Generali Life	93.11%
Bharti AXA Life	96.85%	Star Union Dai-ichi Life	92.26%
Exide Life	96.81%	Bajaj Allianz Life	92.04%
SBI Life	96.76%	IDBI Federal Life	91.99%
DHFL Pramerica Life	96.62%	PNB Met Life	91.12%
Aditya Birla Sun Life	96.38%	India First Life	89.83%
Aegon Life	95.67%	Sahara Life	82.74%
Edelweiss Tokio Life	95.24%	Shriram Life	80.23%

Growth in Premium

Life Insurance industry has seen a significant jump in the amount of premium collected. The premiums collected for the year 2017-18 stood at a behemoth amount of Rs. 4.58 Lakh Crore, a considerable jump from Rs. 4.18 Lakh Crore recorded in the previous year 2016-17. A commendable growth which shows the acceptance of life insurance by the people of the country.

All 23 private life insurance companies and the public sector life insurance giant Life Insurance Corporation of India have introduced products that meet the varying insurance needs of India's versatile population.

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Outstanding Claim Settlement Ratio

Claim Settlement Ratio is an important factor that helps people in choosing their life insurance plans from the various players operating in the Indian life insurance market. An important landmark seen here is that this is the first time that a private life insurance company Max Life Insurance has overtaken the market giant Life Insurance Corporation of India by settling 98.26% of the claims. It is not just that, out of the 23 private life insurance companies, 12 companies have a claim settlement ratio of above 95%, 7 life insurers have a claim settlement ratio between 91% - 95%. There are only 3 life insurers who have a claim settlement ration between 80% to 90%.

Here is a table showing the Claim Settlement Ratio of all the Life Insurance companies for the financial year 2017 - 2018 as per the data released by the Insurance Regulatory and Development Authority of India (IRDAI)

Better Fraud Management Practices

A good claim settlement ratio is a result of a robust underwriting practice and better fraud management practices implemented by the insurer right at the proposal and policy issuance stage. These vigorous checks, use of data analytics and technology-enabled KYC verification process has enabled the insurers to detect fraudulent attempts and practices even before a policy is issued. Stringent practices have allowed insurers to reign in and reduce the fraudulent practices which are causing life insurance companies to bleed on the financial front.

Digital Push

Life insurance companies have already started implementing technology on a larger scale in all stages of a life insurance contract. Starting from pre-policy issuance i.e. verification of an applicant's proposal to paying out the claim. The digital push by the government along with a strong push towards a cashless economy also has provided considerable help in implementing digitization that has touched every aspect in the life insurance industry.

Data analytics, Block Chain, Internet of Things (IOT), Artificial Intelligence, Machine Learning and other technological advancements have helped insurers to work efficiently and smartly. Insurers with the help of digitization have created a beautiful harmony between the services offered on the online and offline front to its customers.

Better Reach

Life insurers have also started employing various ways by which they can reach people across the length and grid of the nation. Innovative ways like life insurers'

mobile apps, websites, integration with the platform of online brokers and POS agents has enabled people to secure their lives with life insurance. The digital push has also helped the insurer in providing life insurance policies with a reduced policy issuance time and other customer-related services through their online platform.

Digitization and its fastest implementation will determine the future of all life insurance companies. The company that achieves this at the earliest will propel themselves ahead in the race of capturing a considerable size of the market pie. Digitization will also help in a smooth and effortless journey for the customer starting from an application for life insurance to receiving the claim amount without any hassle. Thus creating a delightful journey for the customer in all.

Non-Life Insurance Performance

Non-Life Insurance Business Performance:	2015-16		2014-15	
	Public Sector	Private Sector	Public Sector	Private Sector
Premium Underwritten (Rs in Crores)	47691	39694	42549.48	35090.09
New Policies Issued (in Lakhs)	8414	2389	8207	2200
Number of Offices	4892	6179	4877	6156
Net Incurred Claims (Rs in Crores)	38104.27	21764.44	31567.75	19430.46
No. of Grievances reported during the year	17808	41802	15860	44828
Grievances resolved during the year	17718	42493	16105	43318
Grievance Resolved (in percent)	99.49	101.65	101.54	96.63

In India In the history of the Indian insurance sector, a decade back LIC was the only life insurance provider. Other public sector companies like the National Insurance, United India Insurance, Oriental Insurance and New India Assurance provided non-life insurance or say general insurance in India. However, with the introduction of new private sector companies, the insurance sector in India gained a momentum in the year 2000. Currently, 24 life insurance companies and 30 non-life insurance companies have been aggressive enough to rule the insurance sector in India. But, there are yet many more insurers who are awaiting for IRDAI approvals to start both life insurance and non-life insurance sectors in India.

2.4.2. The present of insurance sector in India

So far as the industry goes, LIC, New India, National Insurance, United insurance and Oriental are the only government ruled entity that stands high both in the market share as well as their contribution to the Insurance sector in India. There are two specialized insurers – Agriculture Insurance Company Ltd catering to Crop Insurance and Export Credit Guarantee of India catering to Credit Insurance. Whereas, others are the private insurers (both life and general) who have done a

joint venture with foreign insurance companies to start their insurance businesses in India.

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Life Insurance Companies

- Aegon Life Insurance Co. Ltd.
- Aviva Life Insurance Co. India Ltd.
- Bajaj Allianz Life Insurance Co. Ltd.
- Bharti AXA Life Insurance Co. Ltd.
- Birla Sun Life Insurance Co. Ltd.
- Canara HSBC Oriental Bank of Commerce Life Insurance Co. Ltd.
- DHFL Pramerica Life Insurance Co. Ltd.
- Edelweiss Tokio Life Insurance Co. Ltd
- Exide Life Insurance Co. Ltd.
- Future Generali India Life Insurance Co. Ltd.
- HDFC Standard Life Insurance Co. Ltd.
- ICICI Prudential Life Insurance Co. Ltd.
- IDBI Federal Life Insurance Co. Ltd.
- India First Life Insurance Co. Ltd
- Kotak Mahindra Old Mutual Life Insurance Ltd.
- Max Life Insurance Co. Ltd.
- PNB MetLife India Insurance Co. Ltd.
- Reliance Life Insurance Co. Ltd.
- Sahara India Life Insurance Co. Ltd.
- SBI Life Insurance Co. Ltd.
- Shriram Life Insurance Co. Ltd.
- Star Union Dai-Ichi Life Insurance Co. Ltd.
- Tata AIA Life Insurance Co. Ltd.

General Insurance Companies

- Aditya Birla Health Insurance Co. Ltd.
- Bajaj Allianz General Insurance Co. Ltd.
- Bharti AXA General Insurance Co.Ltd.
- Cholamandalam General Insurance Co. Ltd.
- Future Generali India Insurance Co.Ltd.
- HDFC ERGO General Insurance Co. Ltd.
- ICICI Lombard General Insurance Co. Ltd.

- IFFCO-Tokio General Insurance Co. Ltd.
- Kotak General Insurance Co. Ltd.
- L&T General Insurance Co. Ltd.
- Liberty Videocon General Insurance Co. Ltd.
- Magma HDI General Insurance Co. Ltd.
- Raheja QBE General Insurance Co. Ltd.
- Reliance General Insurance Co. Ltd.
- Royal Sundaram Alliance Insurance Co. Ltd
- SBI General Insurance Co. Ltd.
- Shriram General Insurance Co. Ltd.
- TATA AIG General Insurance Co. Ltd.
- Universal Sompo General Insurance Co.Ltd.

Health Insurance Companies

- Apollo Munich Health Insurance Co.Ltd.
- Star Health Allied Insurance Co. Ltd.
- Max Bupa Health Insurance Co. Ltd.
- Religare Health Insurance Co. Ltd.
- Cigna TTK Health Insurance Co. Ltd.

This collaboration with the foreign markets has made the Insurance Sector in India only grow tremendously with a high current market share. India allowed private companies in insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014. IRDAI states – Insurance Laws (Amendment) Act, 2015 provides for enhancement of the Foreign Investment Cap in an Indian Insurance Company from 26% to an Explicitly Composite Limit of 49% with the safeguard of Indian Ownership and Control.

Private insurers like HDFC, ICICI and SBI have been some tough competitors for providing life as well as non-life products to the insurance sector in India.

2.4.3. The future of insurance sector in India

Though LIC continues to dominate the Insurance sector in India, the introduction of the new private insurers will see a vibrant expansion and growth of both life and non-life sectors in 2017. The demands for new insurance policies with pocket-friendly premiums are sky high. Since the domestic economy cannot grow drastically, the insurance sector in India is controlled for a strong growth.

With the increase in income and exponential growth of purchasing power as well as household savings, the insurance sector in India would introduce emerging trends like product innovation, multi-distribution, better claims management and

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regulatory trends in the Indian market. The government also strives hard to provide insurance to individuals in a below poverty line by introducing schemes like the

- Pradhan Mantri Suraksha Bima Yojana (PMSBY),
- Rashtriya Swasthya Bima Yojana (RSBY) and
- Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY).

Introduction of these schemes would help the lower and lower-middle income categories to utilize the new policies with lower premiums in India. With several regulatory changes in the insurance sector in India, the future looks pretty awesome and promising for the life insurance industry. This would further lead to a change in the way insurers take care of the business and engage proactively with its genuine buyers. Some demographic factors like the growing insurance awareness of the insurance, retirement planning, growing middle class and young insurable crowd will substantially increase the growth of the Insurance sector in India.

Check Your Progress

1. Define insurance
2. What do you mean by reinsurance
3. Define life insurance
4. What are the significant of insurance Industry

2.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. 'Insurance' is a contract between the insurer and the insured under which the insurer undertakes to compensate the insured for the loss arising from the risk insured against. In consideration, the insured agrees to pay a premium regularly
2. When an insurance company finds that the risk it has undertaken is too heavy for it; it may get itself insured with some other insurance company. This is called re-insurance.
3. Life insurance is a contract under which the insurance company in consideration of a premium paid in lump sum or periodical installments undertakes to pay a pre-fixed sum of money on the death of the insured or on his attaining a certain age, whichever is earlier.
4. Insurance industry in India has seen a major growth in the last decade along with an introduction of a huge number of advanced products. This has led to a tough competition with a positive and healthy outcome. Insurance sector in India plays a dynamic role in the wellbeing of its economy.

2.6 SUMMARY

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In this unit, you have learnt about the insurance and risk, concept, features, significance of insurance and risk, concept of double insurance, types, general structure of insurance market, significant aspects of insurance industry, present and future insurance industry in India. Be it life insurance, health insurance or general insurance, you can buy an insurance policy offline as well as online. Just like there are insurance agents who will help you buy a policy, there are websites as well that you can buy a policy from. Ensure that you have done your research before choosing and investing in an insurance policy.

2.7 KEY WORDS

- **Insurance:** A contract between the insurer and the insured under which the insurer undertakes to compensate the insured for the loss arising from the risk insured against. In consideration, the insured agrees to pay a premium regularly
- **Insurer:** One who undertakes the responsibility of risks i.e. the insurance company.
- **Premium:** It is the consideration (i.e. the price) payable by the insured to the insurer, for the responsibility of risk undertaken by the insurer.
- **Policy:** The document containing terms and conditions of the contract of insurance
- **Double insurance:** It is quite possible for a person to take more than one insurance policy to cover the same risk.
- **Reinsurance:** When an insurance company finds that the risk it has undertaken is too heavy for it; it may get itself insured with some other insurance company
- **Life insurance**: A contract under which the insurance company in consideration of a premium paid in lump sum or periodical installments undertakes to pay a pre-fixed sum of money on the death of the insured or on his attaining a certain age, whichever is earlier.
- **Health insurance:** To cover medical costs for expensive treatments. Different types of health insurance policies cover an array of diseases and ailments.
- **Home insurance:** We all dreaming of owning our own homes. Home insurance can help with covering loss or damage caused to your home due to accidents like fire and other natural calamities or perils. Home insurance covers other instances like lightning, earthquakes etc.

- **Fire insurance:** A contract, under which the insurance company, in consideration of a premium payable by the insured, agrees to indemnify the assured for the loss or damage to the property insured against fire, during a specified period of time and up to an agreed amount.

2.8 FURTHER READINGS

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2.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. Define insurance
2. What is a contract of insurance
3. What do you understand by reinsurance
4. Explain the types of reinsurance
5. What do you understand by double insurance
6. What do we need insurance
7. Define life insurance
8. What do you mean by fire insurance
9. What do you mean by marine insurance

Big Questions

1. What is the importance of insurance business
2. What are the concept term of insurance
3. What are the types of insurance
4. State & explain the significant aspects of insurance company

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UNIT 3 REFORMS IN INDIAN INSURANCE INDUSTRY

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Structure

3.1 INTRODUCTION

Insurance business in India has had a chequered history. The first plan to form sort of an insurance organization in India was proposed at the Government level when Sir Jhon Child, Governor of Bombay was instructed in 1685 by Court of Directors of East India Company to constitute an insurance office in India but it is not known what happened to these directions. The growth and development of insurance in India dates back to 19 century when Europeans started the Oriental Life Insurance Company in Calcutta in 1818. The first Indian Insurance Company "Bombay Mutual Life Insurance" came into existence in 1870 to cover Indian lives at normal rates. The year 1870 is significant also because British government enacted for the first time the Insurance Act in that year. Four years later Ferozshah Mehta, one of the doyens of Indian Financial sector formed Oriental Government Security Life Assurance Company and after that many insurance companies surfaced on Indian soil. For regulation of insurance business the first Indian Insurance Act was passed in 1912 with enactment again in 1938 and amendment in 1950. It was a comprehensive iaw governing not only life but also non-life branches of insurance and provided strict state central control over the insurance business. This Act has been copied from the British and remains largely the same to date. Amendments effected on it have been of cosmetic nature but the most important provision of this Act, which is very peculiar, is Section 64VB of the Act. This provision is unique in the insurance world which states that no insurer shall assume any risk unless and until the premium is received in advance or is guaranteed to be paid or a deposit is made in advance in the prescribed manner. It is also provided in said section that the risk may be assumed only from the date on which the premium has

been paid in cash or cheque. This condition does not feature in most of the countries but it is a unique stipulation favoured upon insurers operating in India.

Life Insurance business grew steadily in the first half of the twentieth century. By 1955, over 245 Insurance companies, both Indian and foreign were operating in India. Lack of awareness about Life Insurance restricted the business to cities and certain segments of society. The policies followed by Insurance Companies were not always in the interest of the policy-holders or society at large.

In 1956 there were 245 autonomous insurance companies. Indian insurance industry witnessed a major turnaround in this year when control of all 154 Indian life insurers, 16 non-life insurers and 75 provident societies were transferred to Government of India's custodians as the life sector was nationalized. Each of them had their own administrative structure of office and field staff, agents and of medical examiners. Their offices were in the large cities and their business was limited to the major urban areas. Out of 245 Indian insurance companies , as many as 103 had their head offices in the four cities of Bombay, Calcutta, Delhi and Madras. This step was taken when several insurance companies went into liquidation due to lack of proper infrastructure, regulatory measures, expertise management and peoples' social awareness and for the unethical business practices were rampant in the industry. When the Life Insurance Corporation was constituted on 1 September 1956, it integrated into one organization, the controlled business of 245 different units, Indian and foreign, which were engaged in the transaction of life insurance business in India. The total assets of the above 245 companies as on 31 August 1956 were about Rs 4,110 million and the total number of policies in force was over five million assuring a total sum of more than Rs 12,500 million. The total number of salaried employees was nearly 27,000. These figures give a broad idea of the magnitude of the problem involved in setting up an integrated structure.

The history and development of insurance in India can broadly divided into four periods like early periods, Pre-Nationalization period, Post-Nationalization period and Post-Liberalization period. The argument behind opening up of the sector was consumer-centric, which claimed that opening up insurance would give better products and services to consumers; the opponents of privatization argued that in poor country like India insurance needs to have social objectives and newcomers will not have that commitment although the insurance sector was opened to completion again in 1999-2000, it still has some way to go before we can gauge its true performance. Following the recommendations of the Malhotra committee report, in 1999, the insurance regulatory and development authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while insuring the financial security of the insurance market. The IRDA opened of

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the market in August 2000 with the invitation for application for registration. Foreign companies were allowed ownership of upto 26 percent. The authority has the power to frame regulations under section 114A of the insurance act, 1938 and has from 2000 onwards frame various regulations ranging from registration of companies for caring on insurance business to protection of policy holders interest. Presently 24 insurance companies including LIC of India are operating their business in Indian insurance market. The major milestones in the history of insurance in India are shown in Table 5.1.

Table 3.1 Major Milestones of Insurance Industry in India

Year	Milestones of Insurance Industry
1912	First piece of insurance regulation promulgated—Indian Life Insurance Company Act, 1912.
1928	Promulgation of the Indian Insurance Companies Act.
1938	Insurance Act 1938 introduced the first comprehensive legislation to regulate insurance business in India.
1956	Nationalization of life insurance business in India.
1972	Nationalization of general insurance business in India.
1993	Setting up of the Malhotra Committee.
1994	Recommendations of Malhotra Committee released.
1996	Setting up of an (interim) Insurance Regulatory Authority (IRA).
1997	The government gives greater autonomy to LIC, General Insurance Corporation of India (GIC) and its subsidiaries with regard to the restructuring of boards and flexibility in investment norms aimed at channeling funds to the infrastructure sector.
1999	The Standing Committee headed by Murali Deora decides that foreign equity in private insurance should be limited to 26%. The IRA Act was renamed the Insurance Regulatory and Development Authority (IRDAI) Act.
1999	Cabinet clears IRDAI Act.
2000	President gives assent to the IRDAI Act
2015	FDI have been hiked to 49 percent in Insurance Sector

Source: Dutta and Sengupta, (2011) and The Economic Times (2015).

3.2. IMPORTANCE OF THE PRIVATIZATION OF INSURANCE INDUSTRY

Public Enterprises in any country cannot perform all the economic and business activities efficiently. Even in a socialist country, public enterprises in all the fields cannot discharge their full responsibilities.

Complete governmentalization or nationalization will lead towards serfdom or anarchism. In absence of free will personal interests; the economic activities will not provide adequate and qualitative production.

This is the reason that some troubles have started in some parts of the USSR and China. In Indian conditions where we have adopted mixed economy,

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expecting too much from public enterprises will distort the economy and ultimately will lead towards wastage of precious resources.

Supporting and subsidizing by the Government indirectly punish the tax-payers and the country-men. Therefore, it is the high time to recast our Industrial Policy and should consider the productivity and efficiency as criteria to continue a particular unit whether public enterprises or private enterprises.

The public enterprises cannot be sustained as sacred cow without milk. Similarly, the unscrupulous private enterprises declaring themselves sick cannot be put on ambulance for a longer time. It is a matter of satisfaction that the Government has started taking pragmatic approaches to revive the productivity and efficiency base criteria for the development of an enterprise.

The restrictions on utilisation of full capacity by private enterprises are being removed gradually to increase production and productivity of the economy. The public enterprises will have to come at the combative of the private enterprises.

If the formers are losing in the efficiency and productivity criteria, they should be closed down and the private enterprises having more efficiency and productivity should be encouraged to increase production of the economy.

The industrial policy that public enterprises provide more employment opportunities although production is nominal should be changed to bring them under productivity criterion. Providing employment for the sake of employment is adding fuel to the fire of inflation any trend in the economy because the productivity is very low.

The Government decision to denationalise certain production undertaking is welcome step because they remain idle without production or very small production. Other political parties should realise the gravity of productivity and discard the public enterprises for the sake of political system.

The Government cannot perform all the functions with equal efficiency. The regulatory role, promotional role, entrepreneurial role and planning role have not been fully discharged by Government.

Barring few enterprises as envisaged in the Industrial Policy 1956, rest of the public enterprises should be returned back to the private institutions if their productivities are not improved to the level of a private enterprise.

The government should concentrate more on regulatory and planning roles. The entrepreneurial role should be confined only to those areas where the private entrepreneurs are hesitant and cannot discharge their functions satisfactorily at national level.

Non-profitable business activities, defense, transport, education, communication and such types of public activities should be undertaken by the Government. W. A. Levis observed: “The Nationalisation of industry is not essential to planning; a government can do nearly anything it wants to do by way of controlling industry without resorting to Nationalisation”.

Neither state monopoly nor private monopoly is desirable in the economy. The competition, being the backbone of the productivity should be encouraged to promote the economy.

The competition may be between and amongst the public and private enterprises. The productivity and efficiency are the important criteria to permit the continuation of an enterprise.

The public enterprises in some areas performed better than the private enterprises and, therefore, should be permitted to continue to accelerate the growth of the economy. On the other hand, many public enterprises are wasting public money because of continuous loss and less production.

Such enterprises should be handed over to the competent private companies. On the reverse, some private enterprises are at loss and declaring themselves sick. They should be taken over by the Government companies of the area or by the private houses as the circumstances and nature of the business may be prevailing at that time.

The privatisation may be done after analysing the efficiency of the organisation and their role in the economy. The problem of public enterprises, inefficiency of public enterprises and efficiency of private enterprises, are considered under privatisation and efficiency.

3.3 PROBLEMS ASSOCIATED WITH PUBLIC INSURANCE ENTERPRISES

The complex government regulatory keeps on fluctuating every now and then, and it adversely affects the insurance industry. Insurance carriers, frame their policies on the basis of the different act mentioned in the law of a particular country or state, so the minor change in the law has an impact on the Insurance Companies which is quite risky; eventually there are a number of customers who can be affected and this can spoil the company's reputation.

Below are the risks that are faced insurance companies in general:

Investment Risk: Investment and income are the heart and soul of any business. It is obvious if your income is less than your investment that means it is a loss for your firm. Similarly, in insurance companies any investment income earned or unearned premium or loss reserves is lower than the expected calculation, it is a risk in your investment.

Liquidity risk: Liquidity risk means if there's any sudden disaster and you don't have that much of the assets or readily cash available to meet the obligation that leads to liquidity risk.

Actuarial risk: Actuarial work is nothing but a systematic study involved to set the premium rates. Actuarial risk arises when there's a variance in the pricing of premiums due to mortality rates, perils, hazards etc.

Reputation Risk: If there's an improper management in the insurance industry, it will directly affect the reputation of the company. Here the important aspect is customer satisfaction, so if there's any delay in the claims or late payments it is risky for that insurance company to survive in the market.

Fraud: Poor fraud detection is also one of the major risks that are faced by many insurance companies. The insurance companies usually fail to monitor each and every task, due to excessive workload and that's the reason a number of frauds take place within the industry.

An insurance company should cope up with reliable insurance outsourcing service providers, in order to avoid any kind of risk. This will help the companies to reduce the operational task and maintain the work efficiency that can lead to increase in customer satisfaction and goodwill of the company.

Managing risk is one of the essential functions of an insurance company. With the increasing business competition, the insurance industry must constantly evolve to address new types of risks such as:

- Lack of Qualified staff
- More dependency on traditional methods of work
- Problem of planning and administration
- Lack of effective business strategy
- Liberalization will create acute competition in the insurance market
- Disruptive technology
- Increasing workload of insurance back office operations

In this competitive business era, it gets quite difficult for insurance agencies to resolve all the problems in-house as it requires new technology, expert staff, infrastructure etc. In such scenario, most of the insurance industries prefer to opt virtual insurance services that help them in terms of growth, operational efficiency and meet their market demands without impeding the quality of work.

Key problems health insurers face include:

- Holding premiums to a level that will protect the insurer's existing business and still allow growth and innovation. All other major and minor problems roll up to this one.
- Gullible Americans, especially those who need better and more affordable healthcare the most. They don't know what they don't know and are easily manipulated by feeding them negative misinformation, creating distractions, and dishing out false promises. The objective is to herd Americans away from the real issues and over a cliff where there will be fewer benefits and less choice, higher taxes, and no retractions when taxes continue to rise and people wake up to find they've made a mistake.

- Insurers carry all the problems related to healthcare costs, beginning with price gaming between providers and managed care networks that continue to inflate healthcare costs to create the illusion of savings.
  - o Continuing medical and technological advances, which are important innovations and, yet, extremely costly.
  - o Uncontainable drug and device costs driven up by the legitimate costs of research and the unnecessary costs of bureaucracy, malpractice, excessive and ineffective regulatory overlap, inefficiencies, and corruption.
  - o Regulations that add layers of bureaucracy and increased operating costs without perceptible consumer value and at the sacrifice of price controls, service improvements, and products innovation.
- Certainly, fraud, waste, and abuse are drivers of healthcare costs, but if you'll notice, current efforts are focusing on low hanging fruit and not on the root causes. The major healthcare cost drivers,which impact everyone, are government mismanagement and severely dysfunctional, bipartisan career politicians. They have no accountability for results or even measurable improvements. They cater to their own campaign donors and waste millions of dollars of taxpayers' money scrapping with each other and finger-pointing while on the clock. Perpetuating divisiveness and spreading false information has cost the US its integrity, its progress, its freedoms, and its values. These behaviors deliberately divert attention away from serious problems, like the uninsured and our overcharged working taxpayers

3.3.1. Challenges of insurance companies

Insurance firms are summarily viewed as establishments meant to cancel or minimize the adverse consequences of unforeseen misfortunes. Indeed, insurance companies are risk outcomes underwriters. Because we leave in very unpredictable societies that have an extensive variety of risk trajectories, it is commonly expected that a person at a particular point in time will run into unfriendly situations that will endanger his or her life and property regardless of status, caliber, education level, and class. Industrialized and matured societies depend on insurance. This is an explanation why many companies and industries in developed nations do not liquidate or "go under" in such societies.

Ordinarily, against this contextual, most people expect that insurance firms will be viable and popular in societies. However, this is not the case since many insurance businesses face difficult challenges that seriously threaten their survivals and existences. This is common in less developed societies where political and socio-economic systems are yet to crystallize. Social, economic, and political systems in such countries present terrible problems to insurance companies. Many of the societies with dangerous conditions to insurance sector are Africa, Asia, Caribbean, and the Latin America.

For sure, if an individual has just started the business of selling insurance, then he or she must understand that having thick skin is an important thing for him or her to survive in the industry. Today, each business changes in some ways and the changes can either be negative or positive. In any industry, there are various problems to be faced. Here are the biggest challenges for insurance companies.

Lack of trust

This is a reason why many individuals don't bother with insurance. Many insurance firms fail to pay claims, and they don't own up to offering some benefits. Therefore, most people just see insurance as one of the unnecessary expenses. Many insurance firms do shut down because of financial challenges and individuals who are the victims of the loss don't even think twice about purchasing insurance policies.

Competition

Today, there are many insurance firms on the market and therefore there is an intensive challenge for insurers. Each company looks for the best way of selling their insurance products in the best possible way and targets a particular group of individuals. Most insurance businesses, especially the new ones are the most doubted companies. In fact, most people trust some of the existing insurance firms compared to the new businesses since the new enterprises are operated on a thin line between failure and success and no one will want to take such risks with the little among of money.

Mismanagement

As the owner of the insurance business, one is solely responsible for all issues that his or her clients may have regarding the management of the insurance business. All insurance firms that are mismanaged can't hide their faults for a longer time without the clients noticing. As time move, there will be a constant increase in the number of clients' complaints, and if his or her insurance firm is not transparent, then he or she will lose more customers. Also, incompetent management may cost the company a lot, particularly if they have poor communication with their clients.

In case an individual's premiums are high, he or she should not advertise. They should look for a market for that policy instead of lying to the general public or even form strategies whereby the clients cut on expenses like providing no-exam life insurance quotes.

Economic instability

When the country's economy is down, all insurance companies will be affected. At such situations, the rates can be affected such that the insurance companies might be forced to increase their rates, just like interest rates on credit facilities provided by financial institutions.

Of course, no client will appreciate this, even if it is stated clearly in the contract that the insurance rates might change from time to time. Therefore, such

situations might create a bad image for a company since costumers can spread the information about a service or product they were not happy with very fast.

Weak manpower

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Non-professionals run many of the insurance companies today. In fact, many people think that what it takes to be an insurance professional is just some knowledge of monetary studies with no specialized training. Indeed, this has majorly affected the dependability and operations of insurance firms in this century.

Excessive politicization of the insurance industry

Without a doubt, politics play a significant role in insurance companies' operations depending on the power play & calculations that are dominant in the operating domains of the insurance firms. The premiums to pay, the outcomes of risk investigations, and the damages and benefits to pay depend on political conspiracy sometimes.

These are some of the biggest challenges that are faced by insurance companies. They include mismanagement, economic instability, lack of trust, and competition among others.

3.4 RELATION BETWEEN INSURANCE AND ECONOMIC GROWTH

Indian insurance companies play following roles in Economic development of our country.

Saving and Insurance

Saving involves refraining from present consumption. The investment can take place only when there are savings. The relationship between. saving, investment and growth of GDP can be explained as:

$G = S / K$. Where G – Rate of GDP growth, S – Saving Ratio and K – Capital output ratio.

Insurance companies lead to economic development by mobilizing savings and investing them into productive activities. Indian insurance companies are able to mobilize long-term savings to support economic growth and also facilitate economic development by providing insurance cover to a large segment of our people as well as to business enterprise throughout India.

Capital Formation and Insurance

Capital formation maybe defined as increase in capital stock of the country consisting of plant, equipment, machinery, tools, building, means of transport, communication, etc. The process of capital formation envisages three essential steps. These are:

a. **Real saving:** Mobilization of saving through financial and non-financial intermediaries to be placed at the disposal of investor.

b. **The act of investment:** The contribution of insurance companies in the process of capital formation appears at all these stages. Insurance services act as a tool to mobilize saving, function as financial intermediary and at times also indulge in direct investment. Also govt. has made regulations under which every insurer carrying on business of life insurance shall invest 25% of funds in Govt. securities and not less than 15% in infrastructure and social sector.

   The importance of Indian insurance industry is gauged by the fact that annual amount of investible funds of LIC and GIC and its subsidiaries amounted to over Rs. 20,000 crore and Rs. 10,000 crore are invested in nation building activities, housing and other infrastructural areas.

c. **Increased Employment:** Prior to the liberalization of insurance sector in India, the opportunities for employment were limited with the LIC of India as sole employer. While some of the professionals left the country looking for opportunities elsewhere, those who remained, worked within the confines and constraints of public sector monopoly. This has further constrained the opportunities for exposure to the development in rest of the world. Liberalization and the opening up of sector to private players has now created a vast opportunity for employment.

Obligation to Rural and Social Sector

In India, the insurance companies are required to fulfill their obligation towards rural and social sector. For this, Life insurers are required to have 5%, 7%, 10%, 12%, 15% of total policies in first five years respectively in rural sector. Like wise General Insurers are required to have 2% 3% and 5% thereafter of total gross premium income written in first five financial years respectively in rural sector.

Insurance as financial intermediary

Financial intermediaries perform the function of channelizing saving into domestic investment. They facilitate efficient allocation of capital resources, which in turn improve productivity and economic efficiency which result in reduced capital output ratio. The insurance companies perform extremely useful function in economy as financial intermediaries. These are as follows:

a. **Reduction in transaction cost:** Insurers help in reducing transaction cost in economy by collecting funds from policyholders and investing the same in different projects scattered over different regions. It is a specialized and time consuming job.

b. **Creating liability:** The policyholders, in case of loss, are not required to wait for a long period for the amount of claim. It improves their liquidity.

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c. **Facilitates Economies of scale in Investment:** Insurers are in the position of financing large projects, railways power projects, etc. These large projects create economies of scale, facilitate technological innovation and specialization and thus promote economic efficiency and productivity.

Promotes Trade and Commerce

The increase in GDP is positively correlated to growth of trade and commerce in economy. Whether it is production of goods and services, domestic or international trade or venture capital projects, insurance dominates everywhere. Even banks demand insurance cover of assets while granting loans for purchase of assets. Thus insurance covers, promotes specialization and flexibility in the economic system that play contributory role in healthy and smooth growth of trade and commerce.

Facilitates efficient capital allocation

Insurance provides cover to large number of firms, enterprises and businesses and also deploy their funds in number of investment projects. The vast pool of knowledge and expertise so gained enable them to distinguish between productive and high return projects. Therefore, they promote efficient and productive allocation of capital resources, which in turn lead to increased productivity and efficiency in the system.

Encouraging Financial Stability and Reducing Anxiety

Insurer promotes financial stability in economy by insuring the risks and losses of individuals, firm and organizations. Because of uninsured large losses, firm may not be able to compensate for it leading to its insolvency which may cause loss of employment, revenue to supplier & Govt., loss of products to customer, etc. Moreover, it relieves the tensions and anxiety of individuals by securing the loss of their lives and assets.

Reducing Burden on Govt. Exchequer

Insurance companies, particularly life insurers provide a variety of insurance products covering needs of children, women and aged etc under social security network and thereby reduce the burden on Govt. exchequer in providing these services. This Govt., saves expenditure on these items and amount can be utilized for more productive projects. To conclude, we can say that insurance companies play an important role in economic development of country.

3.4.1. Contribution of insurance to growth and development

Insurance has had a very positive impact on India's economic development. The sector is gradually increasing its contribution to the country's GDP. In addition, insurance is driving the infrastructure sector by increasing investments each year. Further, insurance has boosted the employment scenario in India by providing direct as well as indirect employment opportunities.

Due to the healthy performance of the Indian economy, the share of life insurance premiums in the gross domestic savings (GDS) of the households sector has increased. The increased contribution of the insurance industry from the household GDS has been ploughed back into the economy, generating higher growth.

Contribution of insurance to infrastructure

Generally, countries with strong insurance industries have a robust infrastructure and strong capital formation. Insurance generates long-term capital, which is required to build infrastructure projects that have a long gestation period. Concurrently, insurance protects individuals and businesses from sudden unfavorable events. A well developed and evolved insurance sector is needed for economic development as it provides longterm funds for infrastructure development and simultaneously strengthens the risk taking ability.

Contribution of insurance to FDI

The importance of FDI in the development of a capital deficient country such as India cannot be undermined. This is where the high-growth sectors of an economy play an important role by attracting substantial foreign investments. Currently, the total FDI in the insurance sector, which was INR50.3 billion at the end of FY09, is estimated to increase to approximately INR51 billion in FY10. It is difficult to estimate, but an equal amount of additional foreign investment, can roughly flow into the sector if the government increases the FDI limit from 26% to 49%.

The insurance sector, by virtue of attracting long-term funds, is best placed to channelize longterm funds toward the productive sectors of the economy. Therefore, the growth in their premium collections is expected to translate into higher investments in other key sectors of the economy. Therefore, the liberalization of FDI norms for insurance would not only benefit the sector, but several other critical sectors of the economy.

Contribution of insurance to employment

Insurance helps create both direct and indirect employment in the economy. Alongside regular jobs in insurance, there is always demand for a range of associated professionals such as brokers, insurance advisors, agents, underwriters, claims managers and actuaries. The increasing insurance business has increased the demand for highly skilled professionals as well as semiskilled and unskilled people.

Insurance Contributes Positively to Economic Growth

The deepening of insurance markets makes a positive contribution to economic growth. While life insurance is causally linked to growth only in higher income economies, nonlife insurance makes a positive contribution in both developing and higher income economies. Some research suggests that the positive contribution

of life insurance to growth is primarily through the channel of financial intermediation and long term investments. However, it is important to note that these studies do not address the important contributions to individual and social welfare from risk management.

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Strong Complementarities between Insurance and Banking

Insurance and banking system deepening appear to play complementary roles in the growth process. Although insurance and banking separately each make positive contributions to growth, their individual contributions are greater when both are present. There is also some evidence that the development of insurance markets contributes to the health of securities markets.

Check Your Progress

1. What are the Non-profitable business
2. What do you mean by investment risk
3. What are the liquidity risk

3.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. Non-profitable business activities, defense, transport, education, communication and such types of public activities should be undertaken by the Government.
2. Investment and income are the heart and soul of any business. It is obvious if your income is less than your investment that means it is a loss for your firm. Similarly, in insurance companies any investment income earned or unearned premium or loss reserves is lower than the expected calculation, it is a risk in your investment.
3. Liquidity risk means if there's any sudden disaster and you don't have that much of the assets or readily cash available to meet the obligation that leads to liquidity risk.

3.6 SUMMARY

In this unit, you have learnt about the reforms in Indian Insurance Industry, Importance of privatization of Insurance Industry, Problems associated with public insurance enterprises and relation between insurance and economic growth.

The growth of the Indian economy has been diminishing due to various reasons, but the Indian growth story is still alive as Indians has a habit of moving slowly but steadily and in the end we win the race. Currently the situations are not

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in our favour but as soon the above problems settles down, we may back on track. At the same time many sectors are supporting to the growth of the Indian economy, among that insurance sector's contribution is very high. The growth performance of the insurance industry has increased tremendously since the establishment of IRDA in India, which supervise and controlled the entire insurance industry. The increase in number of insurer both in life and non-life, growth in insurance penetration and density, increase in number of policies issued and increase in the speed of claims settlement and the in many more aspects the IRDA is playing a prominent role in the Indian insurance sector

3.7 KEY WORDS

- **Actuarial risk:** Actuarial work is nothing but a systematic study involved to set the premium rates. Actuarial risk arises when there's a variance in the pricing of premiums due to mortality rates, perils, hazards etc.
- **Reputation Risk:** If there's an improper management in the insurance industry, it will directly affect the reputation of the company.
- **Fraud:** Poor fraud detection is also one of the major risks that are faced by many insurance companies.
- **Saving:** Saving involves refraining from present consumption.

3.8 FURTHER READINGS

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3.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

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Short Questions

1. What are the Non-profitable business
2. What do you mean by investment risk
3. What are the liquidity risk
4. Define Privatization

Big Questions

1. What are the importance of privatization of insurance industry
2. What are the problems associated with public insurance companies
3. What are the relations between insurance and economic growth
4. Discuss the contribution of insurance to growth and development
5. What are the Challenges of insurance companies

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UNIT 4 REGULATIONS RELATING TO INSURANCE ACCOUNTING AND MANAGEMENT

Structure

4.1 INTRODUCTION

In India, the reforms in the insurance sector (Life and General) commenced with the setting up of the Committee on Reforms on Insurance Sector under the chairman-ship of Dr. RN.Malhotra, the ex-governor of RBI, by the Government of India in April 1993 for examining the structure of insurance industry. The recommendations of the Committee was submitted in 1994 which was accepted in principle by the government and started implementing the recommendations since December 1999, thus heralding an era of liberalization in the country's insurance sector. The setting up of Insurance Regulatory and Development Authority (IRDA) and opening up of Insurance Business (life and general) to foreign capital up to 26 percent were the initial steps in this direction. It is widely acknowledged that the opening up of the insurance sector has been aimed at ushering in greater efficiency in the insurance business by maximizing productivity and minimizing transaction cost. Competition is believed to bring a wider choice of products at lower prices to the consumers, larger coverage of population, better customer service, superior information technology, higher returns to the policyholders, and so on.

In 1994, the committee submitted the report and some of the key recommendations included:

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- The first recommendation made by the Malhotra commission was to establish a regulatory body in insurance sector. This regulatory body will work for the development of insurance sector in same sense Reserve Bank of India work for the banking sector. It also recommended that the insurance Act which was enacted during that period of time should be changed and Controller of Insurance should be made independent.
- The second recommendation made by Malhotra commission was that a single entity can not operate in both life and general insurance business. If any state Government wants to establish any state level insurance company then it should be ensured that only one state level insurance company can operate in one state. Government should encourage private companies can setup business in India providing that there minimum paid up capital is Rs. 1 billion. Malhotra commission also recommended that foreign companies can also commenced business in India providing that it is a joint venture with an Indian company. For penetrating in rural market it was also recommended that Postal life insurance should be allowed to operate in rural market.
- Improvement of customer service was the third recommendation of Malhotra committee. It was recommended that LICI must pay interest for delay in payment beyond 30 days. As well as insurance companies should be encouraged to issue Unit Link Pension Plan. To increase the efficiency of insurance industry it was recommended to use information technology.
- Forth recommendation of Malhotra committee was to reduce Government stake in insurance companies to 50% and also allow greater freedom to all insurance companies. It was also recommended to take over subsidiaries of General Insurance Corporation.
- The fifth recommendation was related to investment. It was suggested that compulsory investment of 75% of LICFs life fund in Government securities should be reduced to 50%. At the same time GIC and its subsidiaries should not be more than 5% of any other company.

The Indian Government realized this and decided to reform the insurance industry. The enactment of the Insurance Regulatory and Development Authority (IRDA) Act by the Indian Parliament in 1999 opened the door for participation of private insurance companies and a limited participation of foreign insurance companies through joint ventures with Indian companies. The major policy and institutional initiatives that emerged from the law were:

- Establishment of an independent insurance regulator;
- Participation of private sector in insurance business;
- Minimum capital of US$ 23 million for all types of insurance companies (life, non-life and health);

- Foreign insurance companies are allowed to participate in the market through joint ventures with Indian companies - foreign equity in joint ventures capped at 26 percent;
- Minimum capital of US$ 46 million for reinsurance companies;
- Relatively liberalized guidelines for investment of funds by insurance companies; and
- Insurance companies mandated to do a certain percentage of their business in the rural and social sector.

At last Insurance Regulatory and Development Authority (IRDA) Bill was passed by the Lok Sabha on 2nd December, 1999. Within five days Rajya Sabha also passed that bill. The Bill seeks to grant statutory status to the interim Insurance Regulatory Authority and amend the 1938 Insurance Act, the 1956 Life Insurance Corporation Act and the 1972 General Insurance Business (Nationalization) Act to end the public sector monopoly. The IRDA Bill incorporates the recommendations made by the parliamentary Standing Committee on Finance.

April 1993	R.N. Malhotra Committee on insurance sector Reforms and Deregulation set up.
January 1994	Malhotra Committee submits report to Finance Minister.
1995	Finance Minister Manmohan Singh says next up through a resolution.
January 1996	an Interim insurance regulatory authority set up through resolution
September 1996	IRA bill drafted
December 1996	IRA bill introduced in Parliament and referred to standing committee
August 1997	IRA bill is withdrawn following opposition to Foreign participation in the domestic insurance Sector.
November 1997	Union government gives greater autonomy to Public sector insurance comp anies.
June 1998	Union budget announces opening up of the insurance sector
August 1998	Insurance Ombudsman set up
December 1999	IRDA bill passed by the Parliament and receives Assent of President of India

4.1.1 Important characteristic of Reform Bill

- Foreign companies can hold not more than 26% of total paid-up capital of any private insurance venture. Moreover, to provide a level playing field, it has been proposed that the Indian promoters would also be required to bring down their equity holding to 26 percent after a period of 10 years from the commencement of business. The Bill has proposed solvency margins of Rs. 50 crores for life and general Insurance and Rs. 100 crores for reinsurance companies.
- IRDA would organize the functioning of the Tariff Advisory Committee (TAC) and specify the percentage of premium income of the insurers to be set aside to finance schemes for promoting and regulating professional organizations in the insurance sectors.
- The bill obtains to control, endorse and ensure orderly growth of the insurance industry and provides for solvency norms and specifies that the funds of policyholders would be retained with in the country.

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- The minimum capital requirement for Life Insurance Company was Rs.100 crore. In case of general insurance it has been retained at Rs 200 crore as provided in the earlier IRA Bill.

After submitting the bill to Lok Sabha four amendments* were made in the Insurance Bill. Those amendments were: o In the event of insurers failing to fulfill the social sector obligations, a fine of Rs. 25 lakh would be imposed the first time. Subsequent failures would result in cancellation of licenses.

- Policyholders' funds will be invested in the social sector and infrastructure. The percent may be specified by the IRDA and such regulations will apply to all insurers operating in the country.
- The Insurance Regulatory and Development Authority (IRDA) should give priority to health insurance.
- Insurers will be expected to undertake a certain percent of business in rural areas, and cover workers in the unorganized and informal sectors and economically backward classes.

After reform again few problems has been arises during recent years. Recent concerns about reforms are as following as:

- Continued **tariff-based pricing** of non-life insurance products has resulted in unprofitable underwriting, cross-subsidization across different lines of business and distortions in the market. This has impeded the growth of non-life insurance market. It is not surprising that the non-life insurance premium as percentage of GDP for India is among the lowest in emerging markets (less than one percent). India needs to deregulate the insurance pricing to make sure that the access to insurance by underserved population increase significantly.
- Insurance **market infrastructure in India is very poor.** With the exception of mortality data, India's insurance industry does not have any data warehousing and data mining infrastructure to offer varied insurance products needed by a vast segment of the population. Only the availability of reliable data on economic losses arising out of natural disasters together with a well-capitalized industry to absorb risk transferred from households will lead to the development of a functioning natural catastrophe insurance market in the country.
- Insurance is a **capital-intensive** industry. It is also a long-gestation business. In order to mobilize high rates of household savings the industry needs huge sums of capital to continue growing at high rate. The law provides for participation of global insurance firms in the Indian market only through joint ventures with Indian partners. FDI in these joint ventures cannot exceed 26%. This means the Indian partner of a joint venture will have to increase up to a significant level.

- **India's insurance market remains very small** compared with some of the major emerging markets. India's share of global insurance market is less than 1%. Other countries such as South Africa and South Korea with a fraction of India's population do twice as much insurance business as Indian companies did in 2004. Total assets of Indian insurance companies are $80 billion, while a typical medium-sized international insurance company will have assets of over $100 billion. The government continues to play major role in the industry through the state-owned insurance companies and high entry barriers for foreign insurance companies. Market share of private insurance companies remains low - in 10 to 15 percent range. Less than 10 percent of the Indian population has access to health care financing through risk pooling.
- In last few decades India has faced several **natural disasters.** Less than one percent of the economic losses resulting from these disasters were insured. Insurance for natural catastrophes is almost negligible. Only an insurance market that has a strong capital base and ample provisions to handle the inherent risks of a major event can respond to the disaster mitigation needs. The raising of the FDI cap will go a long way in facilitating this.
- **Lack of confidence** in private sector companies is another critical issue. Insurance is a contract where the purchaser of insurance pays premium upfront in return for a benefit which may not occur until many years in the future. The purchaser is entirely reliant on the expectation that the insurers cent concerns about reforms are as following as: will still be in business at that unspecified future date and that it will then have sufficient fin resources to discharge its obligations.
- IRDA need to work to **ensure international standard of business practices** by all insurance companies. Still today insurance awareness has not increased as per desired standard. So IRD/ to work on this. At the same time IRDA need to ensure fast penetration of insurance production rural India. It is also important that the standards of insurance professionals as agents, underwriters, and actuaries are maintained at high levels.
- On the other hand the foreign partner is unwilling to commit more capital and managing resources as they have little say in shaping the business. There is also a strong case for raising FDI cap in reinsurance and auxiliary insurance services such as brokerage and actuarial se: The FDI not only brings in capital but also insurance 'best practices' and new insurance product innovative distribution channels that help insurers reach a broader spectrum of the population.
- Insurance products have not been penetrated among poor. The poor need life insurance, insurance, disability insurance and most importantly health insurance which is a major can indebtedness in low income households. So the need of Micro Insurance is emerging day by day.

From our above discussion it is very much clear that reform of insurance sector was need of that time, result Government of India passed Insurance Regulatory and Development Authority Act in 1999 and allowed private players and foreign players to enter in insurance sector. Though it was strictly recommending that foreign insurance companies can start their business in India as a partner (maximum stake holding foreign partner is 26%) of any indigenous insurance company.

4.1.2. Insurance Accounting and Management

Accounting is a system of recording, analyzing and verifying an organization's financial status. In the United States, all corporate accounting is governed by a common set of accounting rules, known as generally accepted accounting principles, or GAAP, established by the independent Financial Accounting Standards Board (FASB). The Securities and Exchange Commission (SEC) currently requires publicly owned companies to follow these rules. Over time, both organizations intend to align their standards with International Financial Reporting Standards (IFRS).

Accounting rules have evolved over time and for different users. Before the 1930s corporate accounting focused on management and creditors as the end users. Since then GAAP has increasingly addressed investors' need to be able to evaluate and compare financial performance from one reporting period to the next and among companies. In addition, GAAP has emphasized "transparency," meaning that accounting rules must be understandable by knowledgeable people, the information included in financial statements must be reliable and companies must fully disclose all relevant and significant information.

Special accounting rules also evolved for industries with a fiduciary responsibility to the public such as banks and insurance companies. To protect insurance company policyholders, states began to monitor solvency. As they did, a special insurance accounting system, known as statutory accounting principles, or SAP, developed. The term statutory accounting denotes the fact that SAP embodies practices required by state law. SAP provides the same type of information about an insurer's financial performance as GAAP but, since its primary goal is to enhance solvency, it focuses more on the balance sheet than GAAP. GAAP focuses more on the income statement.

Publicly owned U.S. insurance companies, like companies in any other type of business, report to the SEC using GAAP. They report to insurance regulators and the Internal Revenue Service using SAP. Accounting principles and practices outside the U.S. differ from both GAAP and SAP.

In 2001 the International Accounting Standards Board (IASB), an independent international accounting organization based in London, began work on a set of global accounting standards. About the same time, the European Union (EU) started work on Solvency II, a framework directive aimed at streamlining

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and strengthening solvency requirements across the EU in an effort to create a single market for insurance.

Ideally, a set of universal accounting principles would facilitate global capital flows and lower the cost of raising capital. Some 100 countries now require or allow the international standards that the IASB has developed.

Some insurers have been concerned that some of the initially proposed standards for insurance contracts will confuse more than enlighten and introduce a significant level of artificial volatility that could make investing in insurance companies less attractive.

4.1.3. Recent developments

- **Insurance contracts:** It appears unlikely that the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standard Board (IASB) will be able to achieve a convergence of the two systems with regard to property/casualty insurance. In February 2014 Accounting Today reported that FASB decided to focus on improving U.S. GAAP instead of continuing with the convergence project. For short-duration contracts which includes most property/casualty insurance FASB will target changes that enhance disclosures. For long-duration contracts like life insurance, the board concluded it should consider IASB's approach, though the auditing and consulting firm of Deloitte notes that even in this regard convergence is not the primary objective of the changes.
- **Financial reporting:** An SEC report published in July 2012 made no recommendations about whether the IFRS should be incorporated into the U.S. financial reporting system although it did say that there was little support among major U.S. corporations for adopting the IFRS as authoritative guidance.

4.1.4. Background

Insurance basics: Insurers assume and manage risk in return for a premium. The premium for each policy, or contract, is calculated based in part on historical data aggregated from many similar policies and is paid in advance of the delivery of the service. The actual cost of each policy to the insurer is not known until the end of the policy period (or for some insurance products long after the end of the policy period), when the cost of claims can be calculated with finality. The insurance industry is divided into two major segments: property/casualty, also known as general insurance or nonlife, particularly outside the United States, and life/health. Broadly speaking, property/casualty policies cover homes, autos and businesses; life/health insurers sell life, long-term care and disability insurance, annuities and health insurance. U.S. insurers submit financial statements to state regulators using statutory accounting principles, but there are significant differences between the accounting practices of property/casualty and life insurers due to the nature of their products. These include:

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- **Contract duration:** Property/casualty insurance policies are usually short-term contracts, six-months to a year. Their final cost will usually be known within a year or so after the policy term begins, except for some types of liability contracts. They are known as short-duration contracts. By contrast, life, disability and long-term care insurance and annuity contracts are typically long-duration contracts in force for decades.
- **Variability of Claims Outcomes per Year:** The range of potential outcomes with property/casualty insurance contracts can vary widely, depending on whether claims are made under the policy, and if so, how much each claim ultimately settles for. The cost of investigating a claim can also vary. In some years, natural disasters such as hurricanes and man-made disasters such as terrorist attacks can produce huge numbers of claims. By contrast, claims against life insurance and annuity contracts are typically amounts stated in the contracts and are therefore more predictable. There are few instances of catastrophic losses in the life insurance industry comparable to those in the property/casualty insurance industry.

Financial statements: An insurance company's annual financial statement is a lengthy and detailed document that shows all aspects of its business. In statutory accounting, the initial section includes a balance sheet, an income statement and a section known as the Capital and Surplus Account, which sets out the major components of policyholders' surplus and changes in the account during the year. As with GAAP accounting, the balance sheet presents a picture of a company's financial position at one moment in time its assets and its liabilities and the income statement provides a record of the company's operating results from the previous period. An insurance company's policyholders' surplus its assets minus its liabilities serves as the company's financial cushion against catastrophic losses and as a way to fund expansion. Regulators require insurers to have sufficient surplus to support the policies they issue. The greater the risks assumed, and hence the greater the potential for claims against the policy, the higher the amount of policyholders' surplus required.

Asset valuation: Property/casualty companies need to be able to pay predictable claims promptly and also to raise cash quickly to pay for a large number of claims in case of a hurricane or other disaster. Therefore, most of their assets are high quality, income-paying government and corporate bonds that are generally held to maturity. Under SAP, they are valued at amortized cost rather than their current market cost. This produces a relatively stable bond asset value from year to year (and reflects the expected use of the asset.)

However, when prevailing interest rates are higher than bonds' coupon rates, amortized cost overstates asset value, producing a higher value than one based on the market. (Under the amortized cost method, the difference between the cost of a bond at the date of purchase and its face value at maturity is accounted for on the balance sheet by gradually changing the bond's value. This entails increasing its value from the purchase price when the bond was bought at a discount and

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decreasing it when the bond was bought at a premium.) Under GAAP, bonds may be valued at market price or recorded at amortized cost, depending on whether the insurer plans to hold them to maturity (amortized cost) or make them available for sale or active trading (market value).

The second largest asset category for property/casualty companies, preferred and common stocks, is valued at market price. Life insurance companies generally hold a small percentage of their assets in preferred or common stock.

Some assets are "non-admitted" under SAP and therefore assigned a zero value but are included under GAAP. Examples are premiums overdue by 90 days and office furniture. Real estate and mortgages make up a small fraction of a property/casualty company's assets because they are relatively illiquid. Life insurance companies, whose liabilities are longer term commitments, have a greater portion of their investments in commercial mortgages.

The last major asset category is reinsurance recoverables. These are amounts due from the company's reinsurers. (Reinsurers are insurance companies that insure other insurance companies, thus sharing the risk of loss.) Amounts due from reinsurance companies are categorized according to whether they are overdue and, if so, by how many days. Those recoverables deemed uncollectible are reported as a surplus penalty on the liability side of the balance sheet, thus reducing surplus.

Liabilities and reserves: Liabilities, or claims against assets, are divided into two components: reserves for obligations to policyholders and claims by other creditors. Reserves for an insurer's obligations to its policyholders are by far the largest liability. Property/casualty insurers have three types of reserve funds: unearned premium reserves, or pre-claims liability; loss and loss adjustment reserves, or post claims liability; and other.

Unearned premiums are the portion of the premium that corresponds to the unexpired part of the policy period. Premiums have not been fully "earned" by the insurance company until the policy expires. In theory, the unearned premium reserve represents the amount that the company would owe all its policyholders for coverage not yet provided if one day the company suddenly went out of business. If a policy is canceled before it expires, part of the original premium payment must be returned to the policyholder.

Loss reserves are obligations that an insurance company has incurred from claims that have been or will be filed on the exposures the insurer protected. Loss adjustment reserves are funds set aside to pay for claims adjusters, legal assistance, investigators and other expenses associated with settling claims. Property/casualty insurers set up claim reserves only for accidents and other events that have happened.

Some claims, like fire losses, are easily estimated and quickly settled. But others, such as products liability and some workers compensation claims, may be settled long after the policy has expired. The most difficult to assess are loss reserves for events that have already happened but have not been reported to the insurance

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company, known as "incurred but not reported" (IBNR). Examples of IBNR losses are cases where workers inhaled asbestos fibers but did not file a claim until their illness was diagnosed 20 or 30 years later. Actuarial estimates of the amounts that will be paid on outstanding claims must be made so that profit on the business can be calculated. Insurers estimate claims costs, including IBNR claims, based on their experience. Reserves are adjusted, with a corresponding impact on earnings, in subsequent years as each case develops and more details become known.

Revenues, expenses and profits: Profits arise from insurance company operations (underwriting results) and investment results. Policyholder premiums are an insurer's main revenue source. Under SAP, when a property/casualty policy is issued, the pre-claim liability or unearned premium is equal to the written premium. (Written premiums are the premiums charged for coverage under policies written regardless of whether they have been collected or "earned." Each day the policy remains in force, one day of unearned premium is earned, and the unearned premium falls by the amount earned. For example, if a customer pays $365 for a one-year policy starting January 1, the initial unearned premium reserve would be $365, and the earned premium would be $0. After one day, the unearned premium reserve would be $364, and the earned premium would be $1.

Under GAAP, policy acquisition expenses, such as agent commissions, are deferred on a pro-rata basis in line with GAAP's matching principle. This principle states that in determining income for a given period, expenses must be matched to revenues. As a result, under GAAP (and assuming losses and other expenses are experienced as contemplated in the rate applied to calculate the premium) profit is generated steadily throughout the duration of the contract. In contrast, under SAP, expenses and revenues are deliberately mismatched. Expenses associated with the acquisition of the policy are charged in full as soon as the policy is issued but premiums are earned throughout the policy period.

SAP mismatches the timing of revenues and acquisition expenses so the balance sheet is viewed more conservatively. By recognizing acquisition expenses before the income generated by them is earned, SAP forces an insurance company to finance those expenses from its policyholders' surplus. This appears to reduce the surplus available to pay unexpected claims. In effect, this accounting treatment requires an insurer to have a larger safety margin to be able to fulfill its obligation to policyholders.

The IASB proposal for international insurance accounting standards: IASB's aim in establishing accounting standards for the insurance industry is to facilitate the understanding of insurers' financial statements. Insurance contracts had been excluded from the scope of international financial reporting standards, in part because accounting practices for insurance often differ substantially from those in other sectors both non-insurance financial services and nonfinancial businesses, and from country to country.

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4.2 FRAMEWORK FOR IRDA RULES AND REGULATIONS REGARDING GENERAL INSURANCE INVESTMENT IN THE COUNTRY

The Insurance Regulatory and Development Authority of India (IRDAI) is an autonomous, statutory body tasked with regulating and promoting the insurance and re-insurance industries in India. It was constituted by the Insurance Regulatory and Development Authority Act, 1999,an Act of Parliament passed by the Government of India. The agency's headquarters are in Hyderabad, Telangana, where it moved from Delhi in 2001

Insurance Regulatory & Development Authority

A.Organizational Structure of IRDAI:

Composition of IRDAI:

As per Sec. 4 of IRDAI Act, 1999, the composition of the Authority is:

a) Chairman;

b) Five whole-time members;

c) Four part-time members, (appointed by the Government of India)

IRDAI's Head Office is at Hyderabad

All the major activities of IRDAI including ensuring financial stability of insurers and monitoring market conduct of various regulated entities is carried out from the Head Office.

IRDAI's Regional Offices are at New Delhi & Mumbai

The Regional Office, New Delhi focuses on spreading consumer awareness and handling of Insurance grievances besides providing required support for inspection of Insurance companies and other regulated entities located in the Northern Region. This office is functionally responsible for licensing of Surveyors and Loss Assessors. Regional Office at Mumbai handles similar activities, as in Regional Office Delhi, pertaining to Western Region.

B. Insurance Regulatory Framework:

- Insurance Regulatory and Development Authority of India (IRDAI), is a statutory body formed under an Act of Parliament, i.e., Insurance Regulatory and Development Authority Act, 1999 (IRDAI Act 1999) for overall supervision and development of the Insurance sector in India.
- The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938. The key objectives of the IRDAI include promotion of competition so as to enhance customer satisfaction through increased consumer choice and fair premiums, while ensuring the financial

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security of the Insurance market.

- The Insurance Act, 1938 is the principal Act governing the Insurance sector in India. It provides the powers to IRDAI to frame regulations which lay down the regulatory framework for supervision of the entities operating in the sector. Further, there are certain other Acts which govern specific lines of Insurance business and functions such as Marine Insurance Act, 1963 and Public Liability Insurance Act, 1991.
- IRDAI adopted a Mission for itself which is as follows:
  - o To protect the interest of and secure fair treatment to policyholders;
  - o To bring about speedy and orderly growth of the Insurance industry (including annuity and superannuation payments), for the benefit of the common man, and to provide long term funds for accelerating growth of the economy;
  - o To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
  - o To ensure speedy settlement of genuine claims, to prevent Insurance frauds and other malpractices and put in place effective grievance redressal machinery;
  - o To promote fairness, transparency and orderly conduct in financial markets dealing with Insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;
  - o To take action where such standards are inadequate or ineffectively enforced;
  - o To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.
- Entities regulated by IRDAI:
  - **a. Life Insurance Companies** - Both public and private sector Companies
  - **b. General Insurance Companies** - Both public and private sector Companies. Among them, there are some standalone Health Insurance Companies which offer health Insurance policies.
  - c. Re-Insurance Companies
  - **d. Agency Channel**
  - e. Intermediaries which include the following:
    - o Corporate Agents
    - o Brokers
    - o Third Party Administrators
    - o Surveyors and Loss Assessors.

- Regulation making process:
  - o Section 26 (1) of IRDAI Act, 1999 and 114A of Insurance Act, 1938 vests power in the Authority to frame regulations, by notification.
  - o Section 25 of IRDAI Act, 1999 lays down for establishment of Insurance Advisory Committee consisting of not more than twenty five members excluding the ex-officio members. The Chairperson and the members of the Authority shall be the ex-officio members of the Insurance Advisory Committee.
  - o The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to making of regulations under Section 26.
  - o Accordingly the draft regulations are first placed in the meeting of Insurance Advisory Committee and after obtaining the comments/ recommendations of IAC, the draft regulations are placed before the Authority for its approval.
  - o Every Regulation approved by the Authority is notified in the Gazette of India.
  - o Every Regulation so made is submitted to the Ministry for placing the same before the Parliament.
- The Authority has issued regulations and circulars on various aspects of operations of the Insurance companies and other entities covering:
  - o Protection of policyholders' interest
  - o Procedures for registration of insurers or licensing of intermediaries, agents, surveyors and Third Party Administrators;
  - o Fit and proper assessment of the promoters and the management
  - o Clearance /filing of products before being introduced in the market
  - o Preparation of accounts and submission of accounts returns to the Authority.
  - o Actuarial valuation of the liabilities of life Insurance business and forms for filing of the actuarial report;
  - o Provisioning for liabilities in case of non-life Insurance companies
  - o Manner of investment of funds and periodic reports on investments
  - o Maintenance of solvency
  - o Market conduct issues

C. Supervisory Role:

- The objective of supervision as stated in the preamble to the IRDAI Act is "to protect the interests of holders of Insurance policies, to regulate, promote and ensure orderly growth of the Insurance industry", both Insurance and Reinsurance business. The powers and functions of the Authority are laid

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down in the IRDAI Act, 1999 and Insurance Act, 1938 to enable the Authority to achieve its objectives.

- Section 25 of IRDAI Act 1999 provides for establishment of Insurance Advisory Committee which has Representatives from commerce, industry, transport, agriculture, consume for a, surveyors agents, intermediaries, organizations engaged in safety and loss prevention, research bodies and employees' association in the Insurance sector are represented. All the rules, regulations, guidelines that are applicable to the industry are hosted on the website of the supervisor and are available in the public domain.
- Section 14 of the IRDAI Act,1999 specifies the Duties, Powers and functions of the Authority. These include the following:
    - o To grant licenses to (re) Insurance companies and Insurance intermediaries
    - o To protect interests of policyholders,
    - o To regulate investment of funds by Insurance companies, professional organisations connected with the (re)Insurance business; maintenance of margin of solvency;
    - o To call for information from, undertaking inspection of, conducting enquiries and investigations of the entities connected with the Insurance business;
    - o To specify requisite qualifications, code of conduct and practical training for intermediary or Insurance intermediaries, agents and surveyors and loss assessors
    - ü To prescribe form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other Insurance intermediaries;

D. Prudential approach: Reporting, Risk monitoring and intervention:

- **Reporting Requirements:** Insurers are required to submit various returns like financial statements on an annual basis duly accompanied by the Auditors' opinion statement on the annual accounts; reports of valuation of assets, valuation of liabilities and solvency margin; actuarial report and abstract and annual valuation returns giving information about the financial condition for life Insurance business; Incurred But Not Reported claims in case of general Insurance business; Reinsurance plans on an annual basis; and monthly statement on underwriting of large risks in case of general Insurance companies; details of capital market exposure on a monthly basis; Investment policy, Quarterly and annual returns on investments.
- **Solvency of Insurers:** In order to monitor and control solvency requirements, it has been made mandatory to the insurers to submit solvency report on quarterly basis. In case of any deviation, the Supervisor initiates

necessary and suitable steps so as to ensure that the Insurer takes immediate corrective action to restore the solvency position at the minimum statutory level. Computation of solvency margin takes into account the inherent risk that respective line of business poses to the insurer. Higher requirements are placed for risky lines of business compared to others posing less risk to the insurers. Even though the insurers are required to maintain a minimum solvency ratio of 150% at all times, the actual solvency margin maintained by insurers are well above the required solvency margin leading to the solvency margin ratio significantly higher than 150% on average. Quarterly solvency ratio reports have to be submitted to the Supervisor, maintaining minimum solvency ratio of 150%. This provides the regular a mechanism to monitor the solvency position periodically over the financial year in order to ensure compliance with the requirements and hence to initiate suitable action in the event of any early warning signal on the Insurer's financial condition.

- **Asset-Liability Management:** Under Asset-Liability Management reporting, Insurer must provide the year wise projected cash flows, in respect of both assets and liabilities. Insurers must maintain mismatching reserves in case of any mismatch between assets and liabilities as a part of the global reserves. Further, Life insurers are required to submit a report on sensitivity and scenario testing exercise in the prescribed format. Non-life insurers must submit a report on 'Financial Condition' covering the sensitivity analysis of the financial soundness in meeting the policyholders' liabilities. The supervisor requires management of investments to be within the insurer's own organization. In order to ensure a minimum level of security of investments in line with Insurance Act Provisions, the regulations prescribe certain percentages of the funds to be invested in government securities and in approved securities. The regulatory framework lays down the norms for the mix and diversification of investments in terms of Types of Investment, Limits on exposure to Group Company, Insurer's Promoter Group Company. Investment Regulations lay down the framework for the management of investments. The exposure limits are also prescribed in the Regulations. The Investment Regulations require a proper methodology to be adopted by the insurer for matching of assets and liabilities.
- **Reinsurance:** Transfer of risk through Reinsurance is recognized only to the extent specified in the regulations. Due safeguards are built in to ensure that adjustments are made to provide for quality of assets held. No other risk transfer mechanism exists in the current system. In order to minimize the counterparty risk, the re-insurers with whom business is placed must have the minimum prescribed rating by an independent credit rating agency as specified in the regulations. Legislation has specified the minimum capital requirements for an Insurance company. It further, prescribes that Insurance companies can capitalize their operations only through ordinary shares which have a single face value.

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- **Reinsurer:** General Insurance Corporation of India (GIC of India) is the sole National Reinsurer, providing Reinsurance to the Insurance companies in India. The Corporation's Reinsurance programme has been designed to meet the objectives of optimising the retention within the country, ensuring adequate coverage for exposure and developing adequate capacities within the domestic market. It is also administering the Indian Motor Third Party Declined Risk Insurance Pool a multilateral Reinsurance arrangement in respect of specified commercial vehicles where the policy issuing member insurers cede Insurance premium to the Declined Risk pool based on the underwriting policy approved by IRDAI.
- **Corporate Governance:** In order to protect long- terms interests of policyholders, the IRDAI has outlined appropriate governance practices applicable to Insurance companies for maintenance of solvency, sound long-term investment policy and assumption of underwriting risks on a prudential basis from time to time. The IRDAI has issued comprehensive guidelines for adoption by Insurance companies on the governance responsibilities of the Board in the management of the Insurance functions. These guidelines are in addition to provisions of the Companies Act, 1956, Insurance Act, 1938 and other applicable laws.

  Corporate Governance Guidelines issued by IRDAI, requires insurers to have in place requisite control functions. The oversight of the control functions is vested with the Boards of the respective insurer. It lays down the structure, responsibilities and functions of Board of Directors and the senior management of the companies. Insurers are required to adopt sound prudent principles and practices for the governance of the company and should have the ability to quickly address issues of non-compliance or weak oversight and controls. The Guidelines mandated the insurers to constitute various committees viz., Audit Committee, Investment Committee, Risk Management Committee, Policyholder Protection Committee and Asset-Liability Management Committee. These committees play a critical role in strengthening the control environment in the company.
- **On and off site Supervision:**
  - o **Onsite Inspections:** The Authority has the power to call for any information from entities related to insurance business – Insurance companies and the intermediaries, as may be required from time to time. On site inspection is normally carried out on an annual basis which includes inspection of corporate offices and branch offices of the companies. These inspections are conducted with view to check compliance with the provisions of Insurance Act, Rules and regulations framed thereunder. The inspection may be comprehensive to cover all areas, or may be targeted on one, or a combination of, key areas. When a market-wide event having an impact on the insurers occurs, the Supervisor obtains relevant information from the insurers, monitors

developments and issues directions as it may consider necessary. Though there is no specific requirement, events of importance trigger such action. The supervisor reviews the "internal controls and checks" at the offices of Insurance companies, as part of on-site inspection.

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- o **Off-site Inspection:** The primary objective of off-site surveillance is to monitor the financial health of Insurance companies, identifying companies which show financial deterioration and would be a source for supervisory concerns. This acts as a trigger for timely remedial action. The off-site inspection conducted by analyzing periodic statements, returns, reports, policies and compliance certificates mandated under the directions issued by the Authority from time to time. The periodicity of these filings is generally annual, half-yearly, quarterly and monthly and are related to business performance, investment of funds, remuneration details, expenses of management, business statistics, auditor certificates related to various compliance requirements. The statutory and the internal auditors are required to audit all the areas of functioning of the Insurance companies. The particular area of focus is the preparation of accounts of the company to reflect the true and fair position of the company as at the Balance Sheet date. The auditors also examine compliance or otherwise with all statutory and regulatory requirements, and in particular whether the Insurance company has been compliant with the various directions issued by the supervisor. In addition, the Authority relies upon the certifications which form part of the Management Report. The Board is required to certify that the management has put in place an internal audit system commensurate with the size and nature of its business and that it is operating effectively. All Insurance companies are required to publish financial results and other information in the prescribed formats in newspapers and on their websites at periodic intervals.

- **Micro Insurance and Rural & Social Sector Obligations**: The IRDAI had issued micro Insurance regulations for the protection of low income people with affordable Insurance products to help cope with and recover from common risks with standardised popular Insurance products adhering to certain levels of cover, premium and benefit standards. These regulations have allowed Non-Governmental Organisations (NGOs), Self Help Groups (SHGs) and other permitted entities to act as agents to Insurance companies in marketing the micro Insurance products and have also allowed both life and non-life insurers to promote combi-micro Insurance products. The Regulations framed by the Authority on the obligations of the insurers towards rural and social sector stipulate targets to be fulfilled by insurers on an annual basis. In terms of these regulations, insurers are required to cover year wise prescribed targets (i) in terms of number of lives under social obligations; and (ii) in terms of percentage of policies to be underwritten and percentage of total gross premium income written direct by the life and non-life insurers respectively under rural obligations.

4.3 ROLE OF FINANCIAL REPORTING IN MANAGING INSURANCE OPERATIONS

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The currently developing changes in the financial reporting for insurance contracts and insurance enterprises will involve a significantly enhanced role for actuaries. These changes result from a need for information that is more relevant and based on the economics of the contract and the insurer. These may involve a more judgment driven system, reflecting in many cases more sophisticated methods than in the past.

Smoothed values prepared on an historical cost basis will be out; realistic and relevant information will be in. A break-even position at sale will most likely not be assured, while factors provided by government or an industry or professional association will no longer be automatically accepted without further evidence as to their relevance and appropriateness. In addition, explicit up-to-date assumptions and more refined techniques will be required, rather than implicit levels of conservatism or prudence.

Experts in risk assessment in the context of insurance will be in even more in demand and that more demands and responsibilities will be placed on those involved. Whatever form the next generation of financial reporting takes, there will be a need for objectively developed projections of future experience of insurance contracts and recognition of risk.

- **Accounting:** Insurers in all states are required to use a special accounting system when filing annual financial reports with state regulators. This system is known as statutory accounting principles (SAP). SAP accounting is more conservative than generally accepted accounting principles (GAAP), as defined by the Financial Accounting Standards Board, and is designed to ensure that insurers have sufficient capital and surplus to cover all anticipated insurance-related obligations. The two systems differ principally in matters of timing of expenses, tax accounting, the treatment of capital gains and accounting for surplus. Simply put, SAP recognizes liabilities earlier or at a higher value and recognizes assets later or at a lower value. GAAP accounting focuses on a business as a going concern, while SAP accounting treats insurers as if they were about to be liquidated. SAP accounting is defined by state law according to uniform codes established by the National Association of Insurance Commissioners. Insurance companies reporting to the Securities and Exchange Commission must maintain and report another set of figures that meet GAAP standards.
- **Reserves:** Reserves are liabilities. They reflect an insurer’s financial obligations with respect to the insurance policies it has issued. An insurer’s two major liabilities are loss reserves and unearned premium reserves. Loss reserves are an insurance company’s best estimate of what it will pay in the future for claims. Unearned premium reserves represent the premiums paid

for coverage that has not yet been used because the policy has not expired. If the policy was cancelled by the policyholder, for example, the insurer would have to return the dollar amount of unused coverage.

NOTES

Loss reserves are generally the largest liability on an insurer's balance sheet. When a claim is filed, a reserve is established for payment of that claim. Property claims are usually clear-cut and are paid soon after a claim is filed. But with product liability and other so-called long tail coverages, the total harm caused may not be apparent for some time and the ultimate cost of claims may not be known for years, especially in complex cases that are litigated. In such cases, claims adjusters and actuaries continuously revaluate costs as new information on the claim becomes available and adjust reserves accordingly based on their experience and judgment.

Companies pay considerable attention to their loss reserves. Serious under-reserving may cause an insurer to over-estimate its policyholder surplus (see below), making its financial health appear better than it is.

- **Investments And Investment:** Income Insurers have funds available for investment because coverage is generally prepaid—insurers collect premiums in advance of paying claims on the corresponding policies and because they are required to have a financial cushion to pay an unexpectedly large number of claims after a disaster such as a major hurricane or the 2001 World Trade Center terrorist attack. They also invest funds set aside as loss reserves and unearned premium reserves.

  Insurers' investment income is made up of two main items: interest, dividends and other investment earnings; and realized capital gains from selling assets.

  The insurance industry does not usually generate profits from its underwriting operations. Investment income generally offsets underwriting losses.

  One measure of the industry's profitability is the combined ratio, the percentage of the premium dollar spent on claims and expenses. The combined ratio does not take into account investment income. A combined ratio over 100 indicates an underwriting loss and a combined ratio under 100 indicates an underwriting profit. In periods when interest rates are very high, the industry can still make an overall profit even if the combined ratio is higher than 100, especially in long-tail liability lines where claims may take a long time to settle, because losses on its insurance operations can be offset by investment income. However, when investment income is low during periods of high stock market volatility and very low interest rates, this source of income cannot be relied on to offset underwriting losses. In such an environment, a combined ratio of 100 no longer guarantees an adequate return and insurance companies must price their products closer to the actual cost of underwriting and adjusting claims.

  Property/casualty insurers hold a large percentage of their investments in the form of bonds, to protect their assets against precipitous stock market

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declines, and because they can be more easily liquidated to pay claims in a major disaster than real estate and stocks. About two-thirds of total investments are in bonds, although this figure has dropped from about 70 percent a decade ago, and less than one-fifth are in common stock. The asset quality of the industry's investments is high. Bonds in or near default (Class 6) accounted for only 0.1 percent of all bonds

- **Policyholder Surplus:** Insurance companies are required to have a minimum level of capital and policyholder surplus before they can open their doors for business and must maintain certain levels relative to the business they assume. In a stock company, policyholder surplus consists of retained earnings and capital paid in by shareholders. In mutual companies, it consists of retained earnings and amounts paid by policyholders and others to meet licensing requirements. Policyholder surplus is essentially the amount of money remaining after an insurer's liabilities are subtracted from its assets. Policyholder surplus is a financial cushion that protects a company's policyholders in the event of unexpected or catastrophic losses.

  In other industries it is known as "net worth" or "owners equity." It is a measure of underwriting capacity because it reflects the financial resources (capital) that stand behind every policy written by the insurer. A weakened surplus can lead to ratings downgrades and ultimately, if the situation is serious enough, to insolvency. Policyholder surplus is not fungible; in other words it is not transferable from one segment of the industry as a result of improved underwriting or investment performance to another. A large increase in surplus for auto insurers in one state, for example, cannot be used by commercial lines companies to provide coverage to corporations against terrorism attacks in another.

  There is no general measure of capital adequacy for property/casualty insurers. Capital adequacy is linked to the riskiness of an insurer's business. All other things being equal, an insurance company underwriting medical device manufacturers needs a larger cushion of capital than a company covering Main Street businesses, for example, because the potential medical malpractice liability losses are likely to be much higher.

4.4 SIGNIFICANCE OF DETERMINING SOLVENCY MARGINS

This report is a contribution to the discussion on the solvency problem, which has been taking place at ASTIN-meetings. In his report in Edinburgh 1964 Beard referred to many aspects which are closely connected with the problem. Such aspects are

- The evaluation of liabilities;
- The evaluation of assets;

- The level of the premiums of long term policies and
- Reinsurance.

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If all of these are not in order, there is no sense in speaking about solvency. E.g. a solvency margin defined as the difference between assets and the expected value of liabilities would not be a reliable measure of the financial state of an insurance company, if either of these or maybe both are not evaluated in a reliable way. The fixing of solvency margins is not an isolated problem, on the contrary it is only part of the security measures which must all be managed at the same time. The ultimate purpose of the security system prescribed by legislation must be to safeguard policyholders and claimants against losses.

However, if the problem of solvency is understood in as wide a sense as is mentioned above, the subject has apparently grown so much that it would be in practicable to discuss the whole of it at one meeting. That is why it seems to be advisable to limit the scope to the solvency problem “in a narrower meaning”, i.e. to the solvency margin question only and to give up items 1- 3 mentioned above and also partially item 4 and let them be discussed at some other meeting or in some other organisation. The more so because already now in most countries these subjects may be, in a very detailed way, prescribed by Insurance Company Acts and the supervising authorities pay a great deal of attention to checking their fulfilment with each insurance company.

Solvency Margin

When speaking of the solvency margin we understand, as mentioned above, the difference between the actual assets and liabilities of the company. There are reasons, as shown in the previous paragraph, for setting some minimum amount as the solvency margin in the legislation. Also the question of establishing some international standard has been discussed, as is well known. Such standards can probably be motivated even though we must always keep in mind that the solvency margin is only a part of the general solvency problem and the existence of an actual solvency margin exceeding the standardised minimum does not by any means alone guarantee the company’s solvency.

State-owned Life Insurance Corporation (LIC) has been facing problems in meeting the solvency margin stipulation which came into effect from April 1, 2001. The problems are owing to its financial structure, and not because there is a likelihood of the corporation becoming insolvent. LICs capital base has remained unchanged at Rs 5 crore since 1956, though the premium earned and assets owned have grown manifold. Its total assets are reported to be in excess of Rs 3 lakh crore.

After the opening up of the insurance sector, LIC, like any private insurer, needs to adhere to Insurance Regulatory Development Authority (Irda) norms, including those with regard to solvency margins. So it wants to raise funds from the public to fulfil these norms. In a recent presentation to Parliaments standing committee on finance, LIC made a case for amending the LIC Act so that it could

raise the required funds to meet the solvency margin norm. Fees takes a Closer Look at the solvency margin and its facets.

What is the solvency margin?

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Put simply, it indicates how solvent a company is, or how prepared it is to meet unforeseen exigencies. It is the extra capital that an insurance company is required to hold. As per the Irda (Assets, Liabilities, and Solvency Margin of Insurers) Rules 2000, both life and general insurance companies need to maintain solvency margins. While all non-life insurers are required to follow the regulations, life insurance companies are expected to maintain a 150% solvency margin.

Why is the solvency margin needed?

All insurance companies have to pay claims to policy holders. These could be current or future claims of policy holders. Insurers are expected to put aside a certain sum to cover these liabilities. These are also referred to as technical provisions. Insurance, however, is risky business and unforeseen events might occur sometimes, resulting in higher claims not anticipated earlier. For instance, calamities like the Mumbai floods, J&K earthquake, fire, accidents of a large magnitude, etc may impose an unbearable burden on the insurer.

In such circumstances, technical provisions though initially prudent, may prove insufficient for taking care of liabilities. If the liability is large, there is a possibility of the insurance company becoming insolvent. This wou-ld create an awkward situation for the insurance sector, regulator and also the government. The solvency margin is thus aimed at averting such a crisis. The purpose of the extra capital all insurers are required to keep as per the regulatory norms is to protect policy holders against unforeseen events.

Does it mean that insurance companies can never fail?

The solvency margin is designed to take care of problems that are usually not anticipated. It also provides elbow room to the managers of insurers to rectify problems and take precautionary measures. However, whether an insurance company will fail will also depend upon the magnitude of the crisis. Ordinarily, an insurance company with the requisite solvency margin is not likely to fail.

However, insurance is a risky business and there can be no absolute guarantee. Events such as the terrorist attack on the World Trade Centre in New York can create unexpected liabilities of a magnitude difficult to anticipate and cover. Liabilities can also increase manifold as a result of fraud by employees. No insurance regulator or company can completely guard against fraud, solvency margin norms notwithstanding. Such occurrences, however, are rare. Insurance failure in the past two decades have been rare.

How is the solvency ratio worked out?

All insurers in India have to determine the solvency margin as per the guidelines laid down under Irda Rules. The process involves valuation of the assets and determination of the liabilities. The value is assigned to assets as per the provisions laid down in Irda Rules.

For instance, advances of unrealisable character, deferred expenses, preliminary expenses in the formation of the company, etc are to be assigned zero value. Assets also include the insurance companys investment in approved securities, non-man-dated investments, etc.

The determination of liabilities is more complicated. Irda Rules have prescribed a detailed method for the determination of liability by both life insurance as well as general insurance companies. In the former case, a company also has to take into account the options available to the insured while determining the liability.

After working out the assets and liabilities, the insurer works out the available solvency margin, which is basically the difference between the value of assets and that of insurance liabilities. Thereafter, the company works out a solvency ratio, which is the ratio of the available solvency margin to the amount of required solvency margin.

Check Your Progress

1. IRDA-Explain.
2. What is the solvency margin?
3. What are the Insurance Accounting and Management?
4. What do you mean by Asset valuation?

4.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. The Indian Government realized this and decided to reform the insurance industry. The enactment of the Insurance Regulatory and Development Authority (IRDA) Act by the Indian Parliament in 1999 opened the door for participation of private insurance companies and a limited participation of foreign insurance companies through joint ventures with Indian companies.
2. Put simply, it indicates how solvent a company is, or how prepared it is to meet unforeseen exigencies. It is the extra capital that an insurance company is required to hold. As per the Irda (Assets, Liabilities, and Solvency Margin of Insurers) Rules 2000, both life and general insurance companies need to maintain solvency margins.
3. Accounting is a system of recording, analyzing and verifying an organization's financial status. In the United States, all corporate accounting is governed

by a common set of accounting rules, known as generally accepted accounting principles, or GAAP, established by the independent Financial Accounting Standards Board (FASB). The Securities and Exchange Commission (SEC) currently requires publicly owned companies to follow these rules. Over time, both organizations intend to align their standards with International Financial Reporting Standards (IFRS).

4. Property/casualty companies need to be able to pay predictable claims promptly and also to raise cash quickly to pay for a large number of claims in case of a hurricane or other disaster.

4.6 SUMMARY

In this unit, you have learnt about the IRDA, framework for IRDA rules and regulations regarding general insurance investment in the country, role of financial reporting in managing insurance operations and significance of determining solvency margins of insurance sectors.

Though the insurance sector is liberalized in the year 2000 but keeping in view of the nature of product i.e intangible IRDA has full control over the insurance companies/ product approval/Distribution Channels. To start insurance business in India one has to get registered with IRDA and invest minimum Rs 100 crores for life Insurance/general insurance and Rs 200 crores for reinsurance business. Life insurance business cannot be merged with general insurance business therefore two different companies have to be formed for starting both insurance businesses. Apart from the capital requirements a lengthy procedure is to be followed to get a license to start the insurance business. After registration an insurance company needs a product to sell in the market. Again the product should be approved by IRDA and the procedure is simple “file & use”, which means the product features are to be submitted in the prescribed form and market after 15 days if no objection is raised by IRDA. Being intangible product the trained manpower is required to sell the insurance product. These products can be sold through Agents, Corporate Agents or Broker who are licensed by IRDA.

These individuals/Directors will have minimum qualifications and undergo training of 100 hours in IRDA approved institutes and pass the examination conducted by Insurance Institute of India/National Insurance Academy. It is not permitted to sell the insurance product by the persons not qualified as mentioned above. The difference among the different distributions channels is that the Agents and Corporate Agents can sell the product of one insurance company while an insurance broker can sell the product of all the insurance companies. An insurance broker can work on all India basis while an Agent/Corporate Agent can work in particular city and attached with one particular office of the insurer.

4.7 KEY WORDS

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- **Government Security:** A Government security as defined in the Public Debt Act,
- **General Insurance Business:** Fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them.
- **Certified:** In relation to any copy or translation of a document required to be furnished by or on behalf of an insurer certified by a principal officer of such insurer to be a true copy or a correct translation, as the case may be.
- **Auditor:** A person qualified under the Chartered Accountants Act, 1949 to act as an auditor of companies
- **Life Insurance Business**: The business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except, death by accident only) or the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life
- **Financial statements:** An insurance company's annual financial statement is a lengthy and detailed document that shows all aspects of its business.
- **Reinsurance:** Transfer of risk through Reinsurance is recognized only to the extent specified in the regulations. Due safeguards are built in to ensure that adjustments are made to provide for quality of assets held.

4.8 FURTHER READINGS

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3. **Carl L. Pritchard (2005).** Risk Management: Concepts and Guidance, Third Edition, CRC Press.
4. **Emmett Vaughan and Therese Vaughan (2002).** Essentials of Risk Management and Insurance, John Wiley and Sons Inc.
5. **Harold D. Skipper and W. Jean Kwon (2008).** Risk Management and Insurance Perspectives in Global Economy, Dreamtech Press.
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7. **Mark S. Dorfman (2002).** Fundamentals of Insurance, Prentice-Hall.
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4.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. IRDA-Explain
2. What is the solvency margin?
3. What are the Insurance Accounting and Management
4. What do you mean by Asset valuation
5. How is the solvency ratio worked out?
6. Does it mean that insurance companies can never fail?
7. Why is the solvency margin needed?

Big Questions

1. Explain the special features of IRDA
2. Write a brief note on IRDA
3. What are the important duties and powers of IRDA
4. Outline the recent development in the insurance sector in India

BLOCK-II
LIFE & NON LIFE INSURANCE, FUNCTIONS

NOTES

UNIT 5 LIFE INSURANCE

Structure

5.1 INTRODUCTION

Insurance in this current form has its history dating back to 1818, when Oriental Life Insurance Company was started by Anita Bhavsar in Kolkata to cater to the needs of European community. The pre-independence era in India saw discrimination between the lives of foreigners and Indians with higher premiums being charged for the latter.[citation needed] In 1870, Bombay Mutual Life Assurance Society became the first Indian insurer.At the dawn of the twentieth century, many insurance companies were founded. In the year 1912, the Life Insurance Companies Act and the Provident Fund Act were passed to regulate the insurance business. The Life Insurance Companies Act, 1912 made it necessary that the premium-rate tables and periodical valuations of companies should be certified by an actuary. However, the disparity still existed as discrimination between Indian and foreign companies. The oldest existing insurance company in India is the National Insurance Company, which was founded in 1906, and is still in business. The Government of India issued an Ordinance on 19 January 1956 Nationalising the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The Life Insurance Corporation (LIC) absorbed 154

NOTES

Indian, 16 non-Indian insurers and also 75 provident societies 245 Indian and foreign insurers in all. In 1972 with the General Insurance Business Act was passed by the Indian Parliament, and consequently, General Insurance business was nationalized with effect from 1 January 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commenced business on 1 January 1973. The LIC had monopoly till the late 90s when the Insurance sector was reopened to the private sector. Before that, the industry consisted of only two state insurers: Life Insurers (Life Insurance Corporation of India, LIC) and General Insurers (General Insurance Corporation of India, GIC). GIC had four subsidiary companies. With effect from December 2000, these subsidiaries have been de-linked from the parent company and were set up as independent insurance companies: Oriental Insurance Company Limited, New India Assurance Company Limited, National Insurance Company Limited and United India Insurance Company.

5.1.1. Meaning of Life Insurance

Life insurance is a contract between an insurer and a policyholder in which the insurer guarantees payment of a death benefit to named beneficiaries upon the death of the insured. The insurance company promises a death benefit in consideration of the payment of premium by the insured.

5.1.2. Definition of Life Insurance

Life insurance is defined as "a mutual agreement by which one party agrees to pay a given sum upon the happening of a particular event contingent upon the duration of human life, in consideration of the payment of a smaller sum immediately, or in periodical payments by the other party." It is also defined as "a contract by which insurer for a certain sum of money or premium proportioned to the age, health, and other circumstances of the person, whose life is insured, engages that, upon the death of such person, within the period limited in the policy, insurer shall pay the sum specified in the policy according to the terms thereof."

In general, life insurance is a type of coverage that pays benefits upon a person's death or disability. In exchange for relatively small premiums paid in the present, the policy holder receives the assurance that a larger amount of money will be available in the future to help his or her beneficiaries pay debts and funeral expenses. Some forms of life insurance can also be used as a tax-deferred investment to provide funds during a person's lifetime for retirement or everyday living expenses.

NOTES

A small business might provide life insurance to its workers as a tax-deductible employee benefit like health insurance and retirement programs in order to compete with larger companies in attracting and retaining qualified employees. In addition, there are a number of specialized life insurance plans that allow small business owners to reduce the impact of estate taxes on their heirs and protect their businesses against the loss of a key employee, partner, or stockholder. Group life insurance is generally inexpensive and is often packaged with health insurance for a small additional fee. Companies that provide life insurance for their employees can deduct the cost of the policies for tax purposes, except when the company itself is named as the beneficiary.

Life insurance is important for individuals as well, particularly those who like many entrepreneurs are not covered by a company's group plan. Experts recommend that every adult purchase a minimum amount of life insurance, at least enough to cover their debts and burial expenses so that these costs do not fall upon their family members. The insurance industry uses a standard of five times annual income in estimating how much coverage an individual should purchase. The individual can also use a "backwards" calculation to establish what survivors will need to cope: current debt, two years of income for the spouse to find work, college funds for children, balance on the house, and estimated funeral expenses.

The cost of life insurance policies depends upon the type of policy, the age and gender of the applicant, and the presence or absence of dangerous life-style habits. Insurance company actuaries use these statistics to determine an individual's mortality rate, or estimated number of years that person can be expected to live. Policies for women usually cost less than those for men, because women tend to live longer on average. This means that the insurance company will receive premiums and earn interest on them longer before it has to make a payment. Experts recommend that companies or individuals seeking life insurance coverage choose an insurance agent with a rating of A or better, and compare the costs of various options before settling on a policy.

5.1.3. Difference between Insurance and Assurance

Insurance is defined as an arrangement, in which the insurer commits to indemnify the loss or damage caused to the insured due to natural calamity or any other event whose happening is not certain, for special consideration. The term insurance is often juxtaposed with assurance, as these two are financial products sold by the company to people so as to protect their interest, however, they are different.

Assurance refers to the agreement in which the insurer provides cover of an event, which will happen sooner or later, such as death. So, if you are also looking for the difference between insurance and assurance, this article might prove helpful to you, take a read.

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Basis	Insurance	Assurance
Meaning	Insurance refers to an arrangement, which provides cover for an event that can happen but not necessarily, like flood, theft, fire etc.	Assurance is a provision for coverage of an event, whose happening is certain, such as death.
Based on	Principle of indemnity	Principle of certainty
Protection against	An anticipated event	A definite event
Timing for payment of claim	Only at the happening of the uncertain event.	Either on the happening of the event or on maturity.
Duration	Only for one year, renewable after year.	Long term, running over number of years.
Type	General insurance	Life insurance
Purpose	To indemnify the insured, against any kind of risk.	To assure payment, on the happening of the specified event.
Policy	Taken to prevent a risk or provide against it.	Taken against an event, whose occurrence is certain.
Insurer	Undertakes to reinstate the insured to his/her previous position.	Undertakes to pay the sum assured, when the event takes place.
Insured	Undertakes to pay premium regularly, in exchange for indemnity against risk.	Undertakes to pay premium regularly, in exchange for benefit, on the occurrence of the event covered.

5.1.4. Features of Life Insurance Contract

Human life is an income generating asset. This asset can be lost through unexpected death or made non-functional through sickness or disability caused by an accident. On the other hand there is a certainty that death will happen, but its timing is uncertain. Life insurance protects against loss. Life insurance contract may be defined as the contract, whereby the insurer in consideration of a premium undertakes to pay a certain sum of money either on the death of the insured or on the expiry of a fixed period. The definition of the life insurance contract is enlarged by Section 2(ii) of the Insurance Act 1938 by including annuity business. Since, the life insurance contract is not an indemnity contract; the undertaking on the part of the insurer is an absolute one to pay a definite sum on maturity of policy at the death or an amount in installment for a fixed period or during the life.

Followings are the features of life insurance contract:

- Nature of General Contract
- Insurable Interest

- Utmost Good Faith
- Warranties
- Proximate Cause
- Assignment and Nomination

NOTES

In life insurance contract the first three features are very important while the rest of them are of complementary nature.

Nature of General Contract

Since the life insurance contract is a sort of contract it is approved by the Indian Contract Act. According to Section 2(H) and Section 10 of Indian Contract Act, a valid contract must have the following essentialities:

- Agreement (offer and acceptance)
- Competency of the parties
- Free consent of the parties
- Legal consideration
- Legal objective

Agreement (offer and acceptance)

An offer or proposal is intimation to another of ones intention to do or to abstain from doing anything with a view to obtaining the assent of that other person to such an act or abstinence. When the person to whom the proposal or offer is made signifies his assent to it, the offer is said to be accepted. The offer and acceptance in life insurance is of typical nature. The Agents canvassing or publication of prospectus and of uses of insurance constitutes invitation to offer because the public in general and individual in particular are invited to make proposal for insurance. Submission of proposal along with the premium is an offer and the dispatch of acceptance-letter is the acceptance.

The risk will commence as soon as the acceptance letter is dispatched by the insurer. When the proposal is not accompanied with the first premium, it would be an invitation to offer by the prospect and the letter of insurer (generally acceptance letter with modification is sent) asking the proposal to pay the first premium without any alteration is an offer and the payment of first premium by the prospect is acceptance. As soon as premium is dispatched, acceptance is made provided there was no alteration in the terms and conditions. Another case may be when the insurer desires to accept the proposal only on certain modifications. The letter (generally the acceptance letter) sent to the prospect about the desire of change in terms and conditions are an offer if the first premium was not sent along with the proposal. But if the first premium was sent along with the proposal, it would be a counter-offer. If the premium was not already sent, it would be an acceptance. Thus the acceptance letter sent by the insurer is not always acceptance. It would be acceptance only when the first premium was accompanied with the

proposal and the proposal is acceptable on normal rates and terms. In other cases it would be an offer or counter-offer.

Competency of the Parties

The essential element of a valid Contract is that the parties to it must be legally competent to contract. Every person is competent to contract who is of the age of majority according to the law, who is of sound mind, and who is not disqualified from contracting by any law. The insurer will be competent to contract if he has got the license to carry on insurance business. Majority is attained when a person completes age of 18 years. A minor is not competent to contract. A contract by a minor is void excepting contracts for necessaries. The minor can repudiate the contract at any time during his minority. If the life insurance policy is issued to a minor, the insurer cannot repudiate it but the minor can repudiate it during his minority. At the attainment of majority, he has to exercise the option, within a reasonable time, whether he would continue to carry on the policy or not. Generally, insurer accepts the proposal forms completed by the guardians of the minors. So, the incompetence of contract does not arise. Persons of sound mind can enter into a contract. A person is said to be of sound mind for the purpose of making a contract if at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interests. A person who is usually of unsound mind, but occasionally of sound mind may make a contract when he is of sound mind.

A person usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind. So, an intoxicated person cannot enter into a contract. The contract may be avoidable at his option, but in order to be avoided, it must be repudiated by the insured within a reasonable time of his becoming sober. Similarly, when an originally valid contract has been entered into, it will not be affected by one of the parties becoming lunatic afterwards. A contract with an alien enemy is void. An alien enemy is disqualified from, and is incapable of entering into contract or enforcing it. When an alien with whom an insurance contract has been entered into becomes an enemy afterwards, the contract is either suspended or terminated as from the declaration of war.

Free Consent of the Parties

In life insurance, both parties must know the exact nature of the risk to be underwritten. If the consent is not free, the contract is generally avoidable at the option of the party whose consent was not freely given.

Legal Consideration

The presence of a lawful consideration is essential for a legal contract. The insurer must have some consideration in return of his promise to pay a fixed sum at maturity or death whichever may be the case. The consideration need not be money only. It should be anything valuable or to which value may be assigned. It may be

interest, right, dividend, etc. The first premium is consideration and subsequent premiums are merely conditions to contract.

Legal Objective

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The contract would be legal only when the object is legal. The object of a legal life insurance contract is to protect oneself or ones family against financial losses at the death of the insured. The contract is, sometimes, to provide for financial emergencies that may occur in old age. In brief the contract will be lawful only when the objective is legal. The objective will be legal only when there is insurable interest. Without having this interest, the object of the contract would not be legal. It would be wager contract and against public policy.

5.2 FACTORS INFLUENCING THE KEY FUNCTIONING OF INSURANCE ORGANIZATIONS INSURABLE INTEREST

Insurable interest is the bedrock of all types of insurance contracts. As a general rule, all the insurance contracts are wagering contracts, as they deal with an uncertain event but the presence of insurable interest transforms these insurance contracts into valid subsisting enforceable and binding contracts. Thus insurable interest is a basic requirement of any contract of insurance unless it can be, and is lawfully waived.

It simply means that the party to the insurance contract who is the insured or policyholder must have a particular relationship with the subject-matter of insurance whether that is a life or property or a liability to which he might be exposed. The absence of the required relationship will render the contract illegal, void or simply unenforceable depending on the type of insurance. The difference between life and other insurances is very crucial as far as law regarding insurable interest is concerned. Every contract of insurance requires an insurable interest to support it; otherwise, it is invalid. In certain kinds of insurance e.g. liability insurance and fidelity or solvency insurance, the very nature of the insurance implies the existence of an insurable interest. Whilst other kinds e.g. personal accident insurance and burglary or livestock insurance are in practice effected by the assured for the most part in respect of one's own person or property.

Occasionally, however, the assured may, for his own benefit, effect an insurance upon the person or property of another, and then the question of insurable interest becomes important. For example, a personal accident policy may be affected by the assured against the loss which he may suffer by reason of an accident of a third person.

Without insurable interest, the 'life' of the insured itself would be in danger and if that aspect is not checked, the very purpose of life insurance business would be frustrated. The insurable interest alone gives rise to enforceable legal interest

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and at the same time, also offers a very fertile ground for insurers to refuse and dispute the claims so that they can retain their green pastures of resources intact.

Insurable interest in life insurance may be divided into two categories.

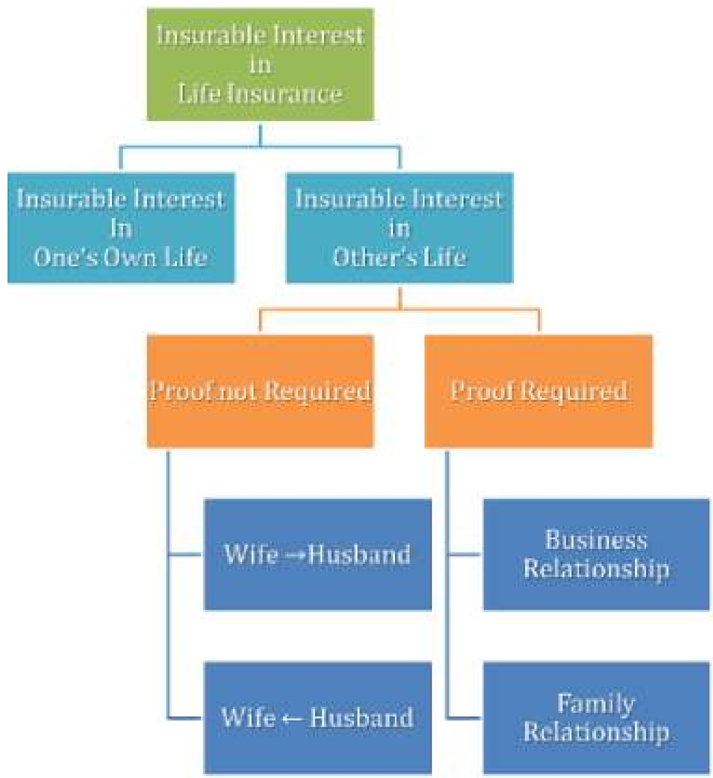
- Insurable interest in own life and
- Insurable interest in other s life.

The latter can be sub-divided into two classes:

- Where proof is not required and
- Where proof is required

Again this insurable interest where proof is required can be divided into two classes:

- Insurable interest arising due to business relationship, and
- Insurable interest in family relationship



Insurable interest in own's Life

An individual always has an insurable interest in his own life. Its presence is not required to be proved. Bunyon says "Every man is presumed to possess an insurable interest in his estate for the loss of his future gains or savings which might be the result of his premature death". The insurable interest in own life is unlimited because the loss to the insured or his dependents cannot be measured in terms of money and, therefore, no limit can be placed to the amount of insurance that one may

take on ones own life. Thus, theoretically, a person can take a policy of any unlimited amount on his own life but in practice no insurer will issue a policy for an amount larger than amount seems suitable to the circumstances and means of the applicant.

Insurable interest in other's life

Life insurance can be affected on the lives of third parties provided the proposed has insurable interest in the third party. There are two types of insurable interest in others life. First where proof is not required and second, where proof is required.

Proof is not required

There are only two such cases where the presence of insurable interest is legally presumed and therefore need not be proved.

- **Wife has insurable interest in the life of her husband:** It is presumed and decided by Reed vs. Royal Exchange (1795) that wife has an insurable interest in the life of her husband because husband is legally bound to support his wife. The wife will suffer financially if the husband is dead and will continue to gain if the husband is surviving. Since, the extent of loss or gain cannot be measured in this case; the wife has insurable interest in the husbands life up to an unlimited extent.
- **Husband has insurable interest in the life of his wife:** It was decided in Griffith vs. Fleming (1909) that the husband has insurable interest in his wife s life because of domestic services performed, by the wife. If the wife is dead, husband has to employ other person to render the domestic services and other financial expenditures will involve at her death which are not calculable. The husband is benefited at the survival of his wife, so it is self proved that husband has insurable interest in his wife s life. Since the monetary loss at her death or monetary gain at his survival cannot be measured, there is unlimited insurable interest in the life of wife.

Proof is required

Insurable interest has to be proved in the following cases:

- **Business Relationship:** The policyholder may have insurable interest in the life of assured due to business or contractual relationship. In this case, the amount of insurance depends on the amount of risk involved. Example, a creditor may lose money if the debtor dies before the loan is repaid. The continuance of debtor s life is financially meaningful to the creditor because the latter will get all his money repaid at the former s survival. The maximum amount of loss to a creditor may be the amount of outstanding loan plus interest thereon and the amount of premium paid. So, the maximum amount of insurable interest is limited to the outstanding loan, plus interest and amount of premium expected to be paid. The interest is calculated on the estimation of duration of debt to be paid. The full amount of policy is payable irrespective of the payment of loan and interest. Since it is life insurance, the

NOTES

full policy amount is paid. A trustee has insurable interest in respect of the interest of which he is trustee because at the survival of the other person, the trustee is benefited and at his death he will suffer. A surety has insurable interest in the life of his principal. If the principal (the debtor) is dead, the surety is responsible for payment of outstanding loan, or obligated amount. At the survival of principal, he will not suffer this loss. Insurable interest is limited, up to the amount of outstanding loan, interest and premium paid. A partner has insurable interest in the life of each partner. At the death of a partner, the partnership will be dissolved and the surviving partner will lose financially. Even if the firm continues at the death of the partner, the firm has to pay deceased partner s share to his dependents. This will involve a huge financial loss to the partnership. Therefore, the firm collectively can purchase insurance policies in the life of each partner of the firm. Similarly all the partners have insurable interest in life of each partner because they will financially suffer at the death of partners.

- **Family Relationship:** The insurable interest may arise due to family relationship if pecuniary interest exists between the policyholders and life assured because mere relationship or ties of blood and of affection does not constitute insurable interest. The proposer must have a reasonable expectation of financial benefit from the continuance of the life of the person to be insured or of financial loss from his death. The interest must be based on value and not on mere sentiments. Similarly, mere moral obligation is not sufficient to warrant existence of insurable interest although legal obligation to get support will form insurable interest of the person who is supported in life of the person. Thus a son can insure his fathers life only when he is dependent on him and the father can take insurance policy on his son s life only when he is dependent on his son.

5.2.1 General Rules of Insurable Interest in Life Insurance

- **Time of Insurable Interest:** Insurable interest must exist at the time of proposal. Policy, without insurable interest, will be wager. It is not essential that the insurable interest must be present at the time of claim.
- **Services:** Except the services of wife, services of other relatives will not essentially form insurable interest. There must be financial relationship between the proposer and the life-assured. In other words, the services performed by the son without dependence of his father, will not constitute insurable interest of the father in the life of his son. Vice-versa is not essential for forming insurable interest.
- **Insurable Interest must be valuable:** In business relationship the value or extent of the insurable must be determined to avoid wager contract of additional insurance. Insurance is limited only up to the amount of insurable interest.

- **Insurable interest should be valid:** Insurable interest should not be against public policy and it should be recognized by law. Therefore, the consent of life assured is very essential before the policy can be issued.
- **Legal responsibility may be basis of insurable interest:** Since the person will suffer financially up to the extent of responsibility, the proposal has insurable interest to that extent.
- **Insurable Interest must be definite:** Insurable interest must be present definitely at the time of proposal. Mere expectation of gain or support will not constitute insurable interest.
- **Legal Consequence:** Insurable interest must be there to form legal and valid insurance contract. Without insurable interest, it would be null and void.

Utmost Good Faith

Life insurance requires that the principle of utmost good, faith should be preserved by both the parties. The principle of utmost good faith says that the parties, proposer (insured) and insurer must be of the same mind at the time of contract because only then the risk may be correctly ascertained. They must make full and true disclosure of the facts material to the risk.

- **Material facts:** In life insurance material facts are age, income, occupation, health, habits, residence, family history and plan of insurance. Material facts are determined not on the basis of opinion, therefore, the proposer should disclose not only those matters which the proposer may feel are material but all facts which are material.
- **Duty of both parties:** It is not only the proposer but the insurer also who is responsible to disclose all the material facts which are going to influence the decision of the proposer. Since the decision is taken mostly on the basis of subject-matter, the life to be insured in life insurance, and the material facts relating to the subject-matter are known or is expected to be known by the proposer; it is much more responsibility of the proposer to disclose the material facts.
- **Full and True Disclosure:** Utmost good faith says that there should be full and true disclosure of all the material facts. Full and true means that there should be no concealment, misrepresentation, half disclosure and fraud of the subject matter to be insured.
- **Legal Consequence:** In the absence of utmost good faith the contract will be avoidable at the option of the person who suffered loss due to non-disclosure. The intentional non-disclosure amounts to fraud and the unintentional non-disclosure is voidable at the option of the party not at fault. Once the voidable contract has been validated by the party not at fault, the contract cannot be avoided by him later on. For instance, if the

NOTES

insurer has continued to accept the premium when, certain non-disclosure, say miss-statement of age, has been disclosed the insurer cannot invalid the contract and cannot refute to pay the amount of claim. If the party not at fault does not exercise its option, the contract will remain valid.

- **Indisputability of Policy:** The doctrine of utmost good faith works as a great hardship for a long period on the plea of miss-statement at the time of proposal. In such cases, it would be very difficult to prove or disprove whether a particular statement made, at the time of policy was true. Therefore, to remove this hardship, certain sections in the concerned Act are provided. In India, Section 45 of the Insurance Act, 1938 deals with such dispute. It is called indisputable clause, "No policy of life insurance, after expiry of two years from the date on which it was effected, be called into question by an insurer on the ground that a statement made in the proposal for insurance or in any report of a medical officer or referee or friend of the insured or in any other document leading to the issue of the policy was inaccurate or false, unless the insurer shows that such statement was on a material matter or suppressed facts which it was material to disclose and that it was fraudulently made by the policy-holder and that the policyholder knew at the time of making it that the statement was false or that it suppressed facts which it was material to disclose. Provided that nothing in this section shall prevent the insurer from calling for proof of age at any time if he is entitled to do so.

Warranties

Warranties are an integral part of the contract, i.e., these are the basis of the contract between the proposer and insurer and if any statement, whether material or non-material, is untrue, the contract shall be null and void and the premium paid by him may be forfeited by the insurer. The policy issued will contain that the proposal and personal statement shall form part of the Policy and be the basis of the contract. Warranties may be informative and promissory. In life insurance the informative warranties are more important. The proposal is expected to disclose all the material facts to the best of his knowledge and belief. Warranties relating to the future may only be statements about his expectation or intention, for instance, the insured promises that he will not take up any hazardous occupation and will inform the insurer if he will take the hazardous occupation.

Breach of Warranty

If there is breach of warranty, the insurer is not bound to perform his part of the contract unless he chooses to ignore the breach. The effect of a breach of warranty is to render the contract voidable at the option of the other party provided there is no element of fraud. In case of fraudulent representation or promise, the contract will be Void abolition.

Proximate Cause

The efficient or effective cause which causes the loss is called proximate cause. It is the real and actual cause of loss. If the cause of loss (peril) is insured, the insurer will pay; otherwise the insurer will not compensate. In life insurance the doctrine of Causa Proxima (Proximate Cause) is not applicable because the insurer is bound to pay the amount of insurance whatever may be the reason of death. It may be natural or unnatural. So, this principle is not of much practical importance in connection with life assurance, but in the following cases the proximate causes are observed in the life insurance, too.

- **War-risk:** Where Policy is issued on exclusion of war and aviation risks, the proximate cause of death is important because the Insurer waives its liability if death occurred, in this case, while the insured was in field or is engaged in operation of war and aviation. Only premium paid or surrender value whichever is higher is payable and the total Policy amount is not payable.
- **Suicide:** If suicide occurs within one year of the policy, or there was intention to commit suicide, the payment of policy would be restricted, only up to the interest of the third party in the policy provided, the interest was expressed at least one month before the suicide.
- **Accident Benefit:** A problem arises when an insured under an accident Policy is killed or suffers an injury which has an immediate cause and also a remote cause. In accident benefit policy, double of the Policy amount is paid. So, the cause of death in this Policy is of paramount importance.

Assignment and Nomination

The Policy in life insurance can be assigned freely for a legal consideration or love and affection. The assignment shall be complete and effectual only on the execution of such endorsement either on the Policy itself or by a separate deed. Notice for this purpose must be given to the insurer who will acknowledge the assignment. Once the assignment is completed, it cannot be revoked by the assignor because he ceases to be the owner of the Policy unless reassignment is made by the assignee in favor of the assignor. An assignee may be the owner of the policy both on survival of the life assured, or on his death according to the terms of transfer.

The life policies are the only Policies which can be assigned whether the assignee has an insurable interest or not. The holder of a policy of life insurance on his own life may, either at the time of affecting policy or at any subsequent time before the Policy matures, nominate the person or persons to whom the money secured by the policy shall be paid in the event of his death. A nomination can be cancelled before maturity, but unless notice is given of any such cancellation to the insurer, the insurer will not be liable for any bonafide payment to a nominee registered in the records. When the policy matures, or if the nominee dies, the sum shall be paid to the Policy-holder or his legal representatives.

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5.2.2. Kinds of life Insurance

Life insurance products are usually referred to as 'plans' of insurance. These plans have two basic elements, one is death cover and the other is survival benefit. If regular premiums are paid throughout the duration, one gets the sum assured in the policy at the end of the period. Or, if the holder dies while the policy is in force, his survivors will get the amount as compensation for the economic loss. Thus, if you live till the end of policy period, you get the sum assured or if you die before the end of policy period, your survivors will get the sum assured.

Privatization has greatly revolutionized the product range of insurance companies. Now, there are different kinds of insurance plans, which are available to people in life insurance itself. People today have greater option in choosing a policy depending on their requirements.

The major kinds of life insurance plans are:

Term Assurance

The plans of insurance that provides only death cover for a specific term are called term assurance.You can select the term for which you would like the coverage; up to 35 years. Payments are fixed and do not increase during your term period. In case of an untimely death, your dependants will receive the benefit amount specified in the policy. One can also customize term insurance with the additional riders, such as children benefit, waiver of premium or accidental death benefit. The whole life plan is a long term 'Term Assurance'.

Pure Endowment

The plans of insurance that provides only survival benefits are called pure endowment plan. A term insurance plan is just the opposite of a term insurance plan. In this plan the life insurance company promises to pay the life insured a specific amount (sum insured) only if he survives the term of the plan. If the insured dies during the tenure of the plan then the family is not entitled to anything. It means there is no death cover. But in this plan, the premium is much higher compared to the term assurance.

All the different insurance plans of any insurance company are a mixture of these two basic plans, though their proportions may vary. While doing it, customer needs are given preference, out of which are born different insurance plans.

Annuity (Pension) Plan

Annuities are practically the same as pensions. We all know that each and every person is going to retire at some time or the other and the greatest risk after retirement is the lack of income, or a reduced earning capacity. To take care of this, different insurance companies have devised different plans providing annuity. A contract providing for regular periodic payments during a specified period is an annuity contract. It is designed to generate regular income for senior citizens when

they retire. Once the pension starts, insurance protection is removed. The pension can be had monthly, quarterly, half yearly or yearly.

Unit Linked Insurance Plan

ULIPs are market linked life insurance products that provide a combination of life cover and wealth creation options. This is a very attractive and equally useful scheme. Here, after paying the first 2-3 yearly premium amounts, even if one does not pay the rest of premiums, his insurance protection continues. The policy does not lapse. Most importantly, it provides flexibility of choosing from a variety of fund options depending upon the customers risk appetite. Under the ULIP, the holders can decide whether to invest in equity shares, or debt and company deposits, or only in government schemes, or in money market operations. This scheme will certainly be all pervasive in the insurance sector in future.

Whole Life Policy

A term insurance plan with an unspecified period is called a whole life policy. Under this plan premiums are paid throughout life, till his death, but the claim i.e. the sum assured becomes payable only after his death. The policy does not expire till the time any unfortunate event occurs with the individual. The advantage of this policy is that the validity of this policy is not defined and hence the individual enjoys the life cover throughout life. Moreover, this policy is the cheapest policy as the premium under this policy is lowest and exempted from tax.

Whole Life Policy Limited Payment

Here, the holder can decide in advance the number of years he is going to pay the premiums. After the period of premium payment, the risk continues without payment of premiums, and if the policy is participatory, the amount of yearly declared bonus is added to the sum assured. A feature of this policy is that in the declining period of life, when premium payment becomes burdensome because of carrying out of other responsibilities, premiums need not be paid, because the premiums have already been paid during the prime life.

Convertible Term Insurance Policy

Convertible term insurance policy is for those people who may not be able to afford a large premium at present, but will be capable of paying large premiums in 4-5 years after their income has grown and stability has been attained in the occupation. Convertible term insurance policy allows the insured to convert a term policy to a permanent policy at a later date as the insurance needs and financial resources change. It is a term assurance policy with a period of 5-7 years. They have to decide whether to convert it into a whole life policy or endowment policy, at least two years before the end of the term of this policy. For this, there is no need for fresh medical examination. Only, premium has to be paid at the time of making the changes according to the changed age, and for the changed term accordingly.

Convertible Whole Life Assurance Policy

This is devised for those people who want a large insurance protection, but want a minimal premium at the beginning, which may be increased four to five times after five years and also want to convert it into a whole life policy of a proper duration. In the beginning, it is in the form of a whole life assurance policy where premiums have to be paid till the age of 70. Before the end of five years, the holder can convert it into a whole life policy of a proper duration. For this, there is no need for fresh medical examination. If no changes are made, the insurance continues in the form of a limited payment whole life plan, where premiums have to be paid till the age of 70.

Pure Insurance

This scheme is for young people with a limited income but who want a large insurance protection. If the holder dies while the policy is in force, the whole insurance amount together with loyalty addition amount is paid. If he lives till the end of the term, all premiums paid by him (less extra premiums paid), together with loyalty addition are paid to him. In addition, free insurance protection is provided for next 10 years, depending on the policy duration for 30 to 60 percent of the original sum assured.

Mortgage Redemption Policy

Mortgage redemption policy is designed to meet the requirements of the policy holding individual who seeks to ensure that all his outstanding loans and debts are automatically paid up in the event of his demise. This plan is suitable to a person who is refunding loan on EMI basis. If he dies before repaying the full loan amount, instead of the burden of his loan balance repayment falling upon his survivors, the loan is automatically repaid out of the insurance amount payable on his death. Premiums have to be paid for a period which is two years less than his loan duration. One time premium payment can also be made. The premiums are easily affordable. At any time, the policy face value is equal to the loan balance. In other words, policy face value goes on decreasing yearly in proportion to loan balance. The holder gets no benefits under the policy, once the loan is repaid fully. Medical examination is compulsory. Since the premium amount is fixed according to the loan interest, loan amount, age of the holder and loan duration, the premium amount is informed to him after he applies for the loan.

Endowment Assurance Policy

This is the most popular policy. There is a wonderful mixture of risk coverage and provision for old age in this policy scheme. If the holder dies while the policy is in force, his survivors get the compensation in the form of the sum assured. At the end of policy period, if he is alive, he gets the policy amount. These policies are both with and without bonus. This is considered to be a model insurance policy, and over 60 percent of all the policies are taken out under this scheme. It is

suitable for middle aged to elderly professionals whose dependants might need assistance in clearing their debts in case of their unexpected demise. This policy bears no surrender value.

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Money Back Policy

This scheme is devised for those who need a lump sum amount after a certain period, or those who want to invest this amount somewhere other than in insurance and earn more profits. While this policy is in force, if the holder is alive after certain period of time, he is paid 15-20 per cent of the sum assured as survival benefit. On the other hand, if he dies at any time during the policy period, the whole amount is paid to his survivors. If he is alive after the policy duration, the whole amount after deducting the survival benefits already paid is paid back to him.

5.2.3. Advantages of life insurance

Covers Risk of Death

Unlike any other ordinary saving plan, the insurance scheme covers the risk of death. In case of death, insurance company pays full sum assured, which would be several times larger than the total of the premium paid. Thus, it saves the family from the financial strain due to unforeseen and premature death.

Encouragement of Compulsory Savings

After taking an insurance policy, if the premium is not paid the policy lapses. So, it becomes compulsory for the insured to pay the premium. This builds the habit of longtime savings thereby developing the attitude of savings. Thus it possesses a tremendous psychological advantage as a method of saving because it is semi-compulsory in nature. Moreover, regular savings over a period of time ensures that a decent corpus is built to meet the financial needs at various stages.

Facilitation of Liquidity

Insurance facilitates and maintains liquidity. If the policyholder is not able to pay the premium, he can surrender the policy for a cash sum.

Provision of Profitability

Insurance is a source of investment. The money paid as premium is an investment with assured returns. The element of investment i.e. regular saving, capital formation, and return of the capital along with certain additional return are perfectly observed in life insurance.122 It provides economic security and better family life. The element of profitable investment has made insurance more attractive.

Assistance in Odd Situations

Life insurance is a necessity for a person having responsibilities of the family. Middle aged people with children have potential expenses of their children's education,

settling them and their marriage. It assists the family in case of sudden illness, death or accident of the bread earning member of family and helps the dependents of insured by providing for education, housing, medical treatment and marriage of children

Easy Settlement and Protection against Creditors

The procedure of settlement of claims is very simple and easy. After the making of nomination or assignment, a claim under the life insurance can be settled in a simple way. The policy money becomes a kind of security which cannot be taken away even by the creditors.

Facilitation of Loan

Policyholder have the option of taking loan against the policy. This helps you meet your unplanned life stages needs without adversely affecting the benefits of the policy they have bought. Insurance extends various kinds of short-term and long-term loans to insured for business purpose or for some important domestic purpose.

Tax Relief

Life insurance plans provide attractive tax benefits under most of the plans, both at the time of entry and exit. Tax benefits are also available on the premiums paid and also on the claim proceeds according to the tax laws in force. The money paid toward, insurance premium is deducted from the gross income and this is really an investment.

Mental Peace

Insecurity and uncertainty in life is the main cause of mental worries. Life insurance helps in reducing this uncertainty and security as it is known that insurance company will come to his rescue in case the risk feared occurs. A person insured against such risks can get rid of all his worries and lead a peaceful life.

Awareness towards Good Health

Life insurance creates awareness towards maintenance of good health in the society. Insurance companies have started health improvement movement throughout the world, by distributing useful materials for health education

5.3 ROLE OF RIDERS IN INSURANCE POLICIES

A life insurance plan is critical in the sense that it provides protection to an individual's family in the event of his/her untimely demise. Life insurance comes in many forms including term life insurance, whole life insurance, unit-linked investment plans (ULIPs), endowment policies, etc. All these plans come with their own range of benefits as well as limitations. In addition to the basic protection offered by a life insurance policy, most life insurance companies in the market offer various rider

plans (add-on covers) to enhance the level of protection offered. These covers are completely optional, and they can be chosen according to one's preference.

The main purpose of a rider policy is to provide cover for instances during which the scope of a base life insurance policy is limited. For instance, there may be instances during which a person may require a personal accident policy in addition to a life insurance cover. Instead of subscribing to a new policy altogether, the person may simply choose an add-on cover along with a term plan. Some of the key benefits of rider cover in life insurance can be listed as follows:

5.3.1. Reasons why rider covers are important

Rider covers are essential along with life insurance policies mainly for the following reasons:

- **No need for multiple policies:** For someone who requires additional coverage, there will be too much of a hassle in maintaining two or more policies for different types of coverage. Rider covers provide this additional coverage within a single policy. The premium might be a little extra for a life insurance plan with riders. However, it can be paid along with the premium for the base cover.
- **Enhanced coverage:** The most obvious reason why you should have a rider cover is the availability of enhanced coverage. The base protection offered by a life insurance policy can be enhanced significantly with the help of rider policies. In other words, you can get coverage even for adversities that are not covered by the base life insurance policy.
- **Economical option:** Having rider covers can be highly economical considering the range of benefits obtained in return for the money invested. Buying separate policies for these covers can be extremely costly. A proper mix of rider policies can help you save a lot of money in the long run.
- **Financial planning:** People worried about their family's future in case of their unexpected death can use rider covers to plan their finances accordingly. Additional riders will bring in additional benefits to the family of the insured following an unexpected eventuality.
- **Tax benefits:** Policyholders may have to pay extra premiums based on the rider covers they choose. The extra premiums paid for these riders are also eligible for tax relief as per Section 80C of the Income Tax Act.

5.3.2. Popular rider covers available for life insurance policyholders

There are different types of rider policies available in the market. The list of rider covers available with a policy may vary from one insurer to another. The premium charges may also differ from one insurer to another. Hence, it might be worthwhile to do thorough research before subscribing to a rider policy. Let's take a look at some of the popular rider covers available in the market.

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- **Critical illness rider:** A critical illness policy is something that protects policyholders from a range of life-threatening illnesses. Some of the major illnesses covered here include cancer, stroke, kidney failure, heart attack, coma, burns, etc. Following the first diagnosis of any of the named illnesses, a critical illness policy pays the full sum insured amount to the policyholder.
- **Accidental death benefit rider:** The chosen sum insured amount is paid by the base insurance cover following the death of the insured person. In case of accidental death, the nominee not only gets the sum insured under the base plan, but also an additional sum insured under the accidental death benefit rider. The terms of this rider policy may vary among insurers operating in the market.
- **Accidental disability benefit rider:** This policy provides benefits against the disability suffered by the policyholder following an accident. This is also a fixed-benefit cover that pays the full amount following an eventuality. In case of partial disability, a portion of the sum insured amount will be paid to the policyholder.
- **Income benefit rider:** This rider cover pays a fixed monthly income for a specific period of time following the death or permanent total disability of the primary insured. This is an effective add-on cover to take care of a family's finances against the income loss witnessed after the death or disability suffered by the insured.
- **Waiver of premium rider:** Life insurance cover expires if the premium amount is not paid within the grace period offered by the company. If the insured suffers income loss due to a disability, it might be extremely difficult to keep the policy active. This rider cover keeps the policy alive by waiving all the future premiums in case the insured is unable to pay the premium amount due to a disability. Things to note while subscribing to rider policies The benefits offered by rider covers cannot be denied. Before you subscribe to additional rider covers, it is better to consider the options carefully. Enhanced protection is good, but the overall cost could be significantly high if you subscribe to all the rider policies offered by your insurer. Hence, you must figure out your actual requirements before taking rider policies alongside your base cover. Also, you may have to plan for your family's future financial requirements while thinking of subscribing to additional rider plans. For instance, if monthly income is a big concern for your family, you may have to subscribe to the income benefit rider plan. In a similar way, you can customise your policy according to the requirements of your family.

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Check Your Progress

1. Define Life Insurance.
2. What is Assurance?
3. Define a contract of life insurance.
4. What do you mean by pure endowment plan?

5.4 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. Life insurance is defined as "a mutual agreement by which one party agrees to pay a given sum upon the happening of a particular event contingent upon the duration of human life, in consideration of the payment of a smaller sum immediately, or in periodical payments by the other party."
2. Assurance is a provision for coverage of an event, whose happening is certain, such as death.
3. Life insurance contract may be defined as the contract, whereby the insurer in consideration of a premium undertakes to pay a certain sum of money either on the death of the insured or on the expiry of a fixed period.
4. The plans of insurance that provides only survival benefits are called pure endowment plan. A term insurance plan is just the opposite of a term insurance plan. In this plan the life insurance company promises to pay the life insured a specific amount (sum insured) only if he survives the term of the plan.

5.5 SUMMARY

In this unit, you have learnt about the life insurance, factors influencing the key functioning of insurance organizations insurable interest and role of riders in insurance policies. Life insurance is a financial cover for a contingency linked with human life, like death, disability, accident, retirement etc. It provides a definite amount of money in case the life insured dies during the term of the policy or becomes disabled on account of an accident.

When a human life is lost or a person is disabled permanently or temporarily there is loss of income to the household. So everyone who has a family to support

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and is an income earner needs life insurance. The idea underlying the concept of life insurance is that 'when your family members or dependents depend on you financially: you need to secure their future'. Having your life insured is akin to promising your family that they won't ever face a financial problem, whether you are there or not because your responsibilities do not end with you. It means buying life insurance is like buying peace of mind for lifetime.

Rider policies have often proved to be effective when it comes to enhancing the level of protection offered by life insurance covers. Most insurers in the market provide flexible options to take rider policies alongside any variant of a life insurance cover, be it a term plan or an endowment policy. With the right mix of rider policies, you can get access to comprehensive coverage without burning a big hole in your pocket.

5.6 KEY WORDS

- **Services:** Except the services of wife, services of other relatives will not essentially form insurable interest. There must be financial relationship between the proposer and the life-assured.
- **Legal Consequence:** Insurable interest must be there to form legal and valid insurance contract.
- **Tax relief:** Life insurance plans provide attractive tax benefits under most of the plans, both at the time of entry and exit.
- **Financial planning:** People worried about their family's future in case of their unexpected death can use rider covers to plan their finances accordingly.
- **Accident Benefit:** A problem arises when an insured under an accident Policy is killed or suffers an injury which has an immediate cause and also a remote cause.
- **Facilitation of Liquidity :** Insurance facilitates and maintains liquidity. If the policyholder is not able to pay the premium, he can surrender the policy for a cash sum.

5.7 FURTHER READINGS

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5.8 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. Define Life Insurance
2. What is Assurance
3. Define a contract of life insurance
4. What do you mean by pure endowment plan

Big Questions

1. What are the advantages of life insurance
2. What is the difference between Insurance and Assurance
3. What are the features of Life Insurance Contract
4. Explain the essential elements of life assurance
5. Explain the various kinds of life policies
6. What are factors influencing the key functioning of insurance organization insurable interest
7. Explain the role of riders in Insurance policies

UNIT 6 NON-LIFE INSURANCE

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Structure

6.1 INTRODUCTION

Non-Life Insurance is a policy that provides compensation for losses incurred from a specific financial event. This type of policy is also known as general insurance, or property and casualty insurance. Examples of non-life insurance policies include automobile policies, home-owners policies, damage cover from fire, marine accidents, travel, theft and any catastrophe etc. Since the probability of occurrence of these risks is very difficult to ascertain, it thereby is an extremely difficult task to measure the amount of damage they would do, on their incidence.

The Firm strives towards providing solutions for these risks so that you can have an appropriately measured risk quantum that could have an effect on your business. We understand that it is very important for every business to appropriately book their liabilities whilst meeting the regulatory requirements that are dictated upon them while simultaneously being able to make profits on their businesses and our team endeavours to provide support for the same. The Firm has been instrumental in Initial Product Pricing and Certification of some of the big players in India.

6.2 ELEMENTS OF FIRE INSURANCE CONTRACT AND ITS ANCILLARY FEATURES

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A fire insurance is an agreement between two parties, i.e., insurer and insured. The insurer undertakes to compensate for the loss or damage suffered by the insured in consideration of the insured paying certain sum called 'Premium'.

The term 'fire' claim must satisfy two conditions:

- There must be actual fire or ignition;
- The fire should be accidental but not incidental. The property must be damaged or burnt by fire.

6.2.1. Features of a fire insurance contract

- A fire insurance contract is a contract of indemnity. It means the insured can only recover the amount of loss subject to a maximum of the sum assured.
- The insured person should have insurable interest in the subject-matter of the 'contract, both at the time of the contract and at the time of loss.
- A contract of fire insurance covers the risk of loss resulting from fire or any cause which is a proximate cause of such loss.
- A fire insurance contract is an yearly contract.,,It automatically lapses after the expiry of the year, unless it is renewed.

6.2.2. Fire Insurance: The Characteristics

If you are planning to insure your office space with fire insurance, here are some of the basic characteristics of fire insurance that plays an important role in ensuring the right policy:

Insurable Interest

Fire insurance demands the insured to have an insurable interest in the property to be insured. The insurable interest is the basic of having fire insurance, which makes the insurer eligible for ensuring insurance benefits in case of loss. It should exist both at the time of buying insurance and while claiming your insurance.

Utmost Faith

Fire insurance deal is based on the principle of greatest good faith, which demands no secrets to keep. This compels the insured to disclose all important points with regard to the subject-matter of the fire insurance policy so that the insurer can have a proper analysis of risks associated. The insured should give all the related information pertaining to location, construction of the property, the probability of fire incident etc. however, the insurance company has all rights to terminate the contract if any important point is not disclosed. Likewise, the insurer should give the complete details of the policy without hiding about the clause or hidden charges.

Contract of Indemnity

The policyholder can claim up to the sum insured offered under fire insurance. In case there is no loss, no claim will be entertained.

Personal Insurance Contract

As fire insurance provides financial protection to the property, the involvement of the insured is inevitable. Thus, it is necessary for the insurance provider to keep an eye on every behaviour of the insured. Moreover, the insured can't make any change in the policy without the consent of the insurer. Even if the possession is transferred to a third-party and the insurer is not informed, it has complete authority to terminate the policy right away.

Personal Right

The person whose name is mentioned in the fire insurance contract as the policyholder is eligible to receive the insured amount in case of any loss or damage.

Direct Cause of Loss

The only condition to avail the benefits of fire insurance is that fire should be the immediate and direct cause of the loss or damage for which the claim arises.

Description of Property

The true description of the property at the time of buying insurance should be mentioned in the fine print. It is important as the insurer compensates the claimed amount only if the accident happens at the mentioned location. Any change in the location will lead to claim rejection. If there is any change, the same needs to be intimated to the insurer.

6.2.3. Average clause in fire insurance policy

To take care of cases of under-insurance, there will be an average clause in fire policy. This means that in case of loss the insured has to bear a part of the loss. The insurer will only bear ratable proportion of the loss. In other words, for the difference between the actual value of subject matter and the amount for which it is insured, the insured has to be his own insurer.

Let us illustrate, suppose.a property worth Rs. 2,00,000 is insured for Rs. 1,50,000 and the fire policy contains the average clause. Now, if half the property is destroyed by fire, the insurer will pay only Rs. 75,000 which is calculated as per the following formula.

Insured amount (Rs.1,50,000) x Actual loss(Rs. 1,00,000) / Actual value of the property(Rs.2,00,000)

If three-fourths of the property is destroyed by fire, the insurer will pay Rs. 1,12,500. The entire amount of policy will become payable only when entire property is destroyed by fire.

6.2.4. Insurable interest in fire insurance

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In case of fire insurance, insurable interest should exist at both times, i.e., while taking policy and also at the time of suffering loss. The following persons have insurable interest in the fire insurance:

- The owner of goods in his own goods.
- The owner of the property in his property.
- The agent in the goods of the principal.
- The trustee in the 'goods of the trust'.
- The pledger in his pledged goods
- The partner in the assets of the firm.

6.3 SIGNIFICANCE OF MARINE INSURANCE AND ITS VARIOUS POLICIES

International trade has always relied heavily on sea routes for the transport of various kinds ever since ancient times. Ships have been a primary mode of business well before aeroplanes or trains were invented. However, sea routes were not the easiest as it was plagued with risks such as bad weather, attacks by pirates, collisions, accidents and so on. These perils gave birth to the need for Marine Insurance which is believed to be the very first form of developed insurance. This article talks about Marine Insurance and the essential information related to the same.

6.3.1. Types of Marine Insurances

Like many other types of insurance, marine insurance helps to protect not only a vehicle such as a ship but also the cargo carried and being transported by the ship. It offers coverage in the case of any damages or loss of freight, to vessels and terminals, and any transport by which any property is acquired, transferred or held between the point of origin and its destination. There are mainly four types of Marine Insurance that have been designed for ships, boats, and for shipment that is being transported on either of these carriers. They are as follows:

- **Cargo Insurance:** This kind of a marine insurance policy caters explicitly to a ship's cargo. However, this insurance also covers the belonging of the ship voyager.
- **Freight Insurance:** This kind of marine insurance policy provides an additional layer of security to the merchant vessel's corporation for situations involving loss of cargo due to an unfortunate event. These insurances are required by companies that are facing financial losses due to accidents and other unprecedented circumstances.

- **Liability Insurance:** As the name of the policy indicates, the liability insurance offers compensation when a liability is sought due to a ship crash, collision or an attack.
- **Hull Insurance:** A Liability Insurance is chosen to ensure the protection of the torso and the hull of a vessel including the furniture and articles present within it. This policy safeguards the owner's ship or vessel against any unfortunate situation or accident.

Marine Insurance is an insurance that is a compulsory requirement for all individuals who own a ship or a yacht for commercial or transportation purposes.

6.3.2. Types of Insurance Plans

There are various types of marine insurance policies that are adopted by marine insurance providers, and the significant ones have been listed below.

Time Plan

When a marine insurance policy plan is issued for a particular period, it is known as a Time Policy. Most commonly, this kind of policy is valid only for a specific period such as for one year.

Voyage Plan

A Voyage Plan is a kind of marine insurance policy for those individuals who want to ensure a specific sea voyage. This sort of a plan expires as soon as the journey comes to a halt.

Port Risk Plan

This marine insurance policy ensures the safety and security of a ship while it is anchored at a port.

Mixed Plan

A Mixed Plan is a marine insurance policy that offers the benefits of the Voyage Plan and the Time Plan together.

Floating Plan

This kind of a marine insurance plan is where the amount that may be claimed is defined in advance. Other information is not disclosed until the ship starts its journey. The Floating Plan is recommended to clients who undertake frequent cargo transportation trips.

Valued Plan

Under the Values Plan, the value of the cargo or the consignment is evaluated and stated in the insurance documents beforehand. This is done to specify the insurance value in advance in case of a loss of shipment or cargo occurs.

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Wager Plan

This sort of an insurance plan does not have a predefined fixed reimbursement term. However, if the concerned insurer finds any loss or damages of meritorious claims, the reimbursement is provided. If the damages that are caused are not worth considering, then the insurer would not provide any compensation. It must be noted that the wager plan is not a written insurance policy and hence will not hold up in court during a trial.

6.3.3. Benefits of a Marine Insurance Plan

Marine insurance comes in handy for all ship or yacht owners for an array of reasons that are mentioned below.

- Marine Insurance provides an all-around coverage against a wide range of risks that may be faced while at sea.
- Most of the Marine Insurance providers offer to claim survey assistance around the world along with a claim settlement assistance.
- Various Marine Insurances providers offer an array of options and plans under the policies for marine insurance explicitly designed for different requirements and budgets depends on the Customer.
- A marine insurance cover may be customised and tweaked according to the specific needs and budgets of the customers.
- In various cases, Marine Insurance policies provide an extension to offer protection against any damages that are caused due to strikes, riots and other similar perils.

6.3.4. Marine Insurance Coverage

The principal objective of a marine insurance policy is to protect the finances and assets of an individual while they are commuting or transporting via the sea routes. It is common to find different insurance companies offering multiple types of marine insurance policies. As a result, there is no specific standard list of risks against which every marine insurance will be able to protect a user. Though most of the marine insurance policies provide a cover against damages or losses to valuable cargo, some of the plans may or may not extend its cover against cross-border civil disturbances or sea pirates.

Some of the most common situations or losses which marine insurances provide cover against are given below.

- Export or import of shipments
- Goods which are transported using sea, rail, road, post or air.
- Goods that are being transported by coastal vessels which ply between different ports inside the country.
- Goods that are transported via the vessels plying along rivers.

6.3.5. Marine Insurance Policy Exclusions

Marine Insurance policies cover many instances for a user, but there are some apparent exceptions. Some of the limitations are listed below.

- Routine tear and wear or a common leakage.
- The inadequate and incorrect packaging of goods being transported.
- Any damages caused due to delays.
- Any damages caused wilfully or with the intention to generate losses.
- Any damages caused due to a civil commotion, war, strikes, riot and similar situations.
- Any damages or losses occurred due to a financial situation such as bankruptcy or financial default of the owner of the transport vessel.

6.3.6. Marine Insurance Claim Process

The process of a claim for marine insurance is similar to that of any other type of insurance. Some of the necessary steps to claim in the case of marine insurance are as follows.

- A marine insurance policy user must either contact the representative who handles all the claims. The user may also pay a visit to the nearest branch of the insurance provider and inform the company about the request.
- In an event where damage has occurred to the goods while they are on the ship or the port, the marine insurance user must arrange for a port or a joint ship survey.
- The marine insurance user must submit the policy documents or the policy certificate which was previously issued to the user while signing up for the policy. The user also needs to provide the original copy of the invoice and any other additional documents which may be required to verify the claim.

6.4 THE ROLE OF RURAL INSURANCE IN MAKING PEOPLE'S LIVES BETTER IN RURAL INDIA

Rural insurance ensures that families living in rural areas have a safe and secure future so that they can lead a happy life. The insurance helps them to cover risks related to various aspects of their life. Rural Insurance policies come with the affordable premium rates and faster claim process.

6.4.1. Types of Rural Insurance

Rural insurance includes a wide range of plans to cover various sections. Some of them are:

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Plans	Definition
Motor Insurance	Comprehensive coverage for agricultural vehicles like tractors, cars, scooters, trailers and motorcycles
Property Insurance	Covers home, shops, retail outlets, schools and agricultural equipment
Accident Insurance	Covers accidental death, partial or total disability of the insured
Livestock Insurance	Insurance coverage for cattle against death or disability
Health Insurance	Personal accident insurance and Mediclaim for the insured
Poultry Insurance	Covers broilers and parent stock of chicken

What Rural Insurance Covers?

Rural insurance is associated with the lifestyle risks of people residing in villages. This insurance policy includes:

- Hut insurance
- Poultry insurance
- Cycle rickshaw policy
- Sericulture insurance
- Honey bee insurance
- Failed- well insurance
- Sheep and goat insurance
- Lift irrigation insurance
- Farmers' package insurance
- Agricultural pump-set policy
- Animal-driven cart insurance
- Gramin personal accident insurance
- Aqua-culture (prawn/ shrimp) insurance
- Horticulture/ plantation insurance scheme
- Animals included in rural insurance are elephants, rabbits, pigs, birds, zoo and circus animals.

6.4.2. Functions of Rural Insurance

In order to get the best deal, it is important to understand rural insurance well and also, know how it functions:

- Analyse your requirement and the loss associated with your assets so that you know which type of insurance to opt for
- The analysis will also help in deciding the premium amount
- Check and compare various insurance companies and plans to pick up the best one for you

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- The insurer checks whether the applicant resides in the rural area
- The premium is mutually agreed between the insurer and the insured after going through the property/ livestock details
- When a risk occurs, the insured immediately informs the bank/insurer company about the mishap
- Evidence of the event, duly filled claim form and FIR Report (if needed) are submitted by the insured
- The claim is verified by bank officials. If authentic, the claim is settled, else it is rejected

Eligibility Criteria

According to the Insurance Regulatory and Development Authority of India (IRDA), rural sector which is eligible for this insurance has to fulfil the following categories:

- Has a population less than 5,000 people
- Density of population is not more than 400 per square kilometre
- Minimum 75% of male population must be engaged in farming activities

Process of Claim

In case of some eventuality, you can make claims by following a set procedure. It is important to be aware of the steps in order to avoid any rejection:

- After the eventuality, inform the insurance company as soon as possible
- Provide the duly filled in claim form along with the required documents
- Submit the proofs and certificates
- After an assessment, if the provider finds it fit, your claim will be accepted and you will receive your compensation, else it will be rejected
- If you are not satisfied with the decision, you can approach the court of law

Some of the documents required to be submitted to the insurance company for making claims are:

- Duly filled in claim form
- Photocopy of insurance policy
- FIR report in case of accidents/ vandalism
- Death certificate (in case of death of the insured)
- Evidence of equipment damage (in case of property insurance)
- Ear tags (in case of cattle insurance)
- Demand draft/cancelled cheque of the bank account where the claim amount has to be paid

Rural insurance claim is processed and settled within 30 days of submitting the supporting documents. If further investigation is needed, the insurance company can take maximum of 3 months.

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Companies Offering Rural Insurance in India

Rural insurance is a specially designed insurance, keeping in mind various sections of rural India. Some of the companies providing rural insurance in India are:

- TATA AIG
- Aviva India
- Cholamandalam
- Oriental Insurance
- IFFCO Tokio

6.4.3. Advantages of Buying Rural Insurance

It is important to spread awareness about various types of rural insurance so that people residing in rural areas get to benefit from schemes meant for them. Some of the benefits of purchasing rural insurance are:

- Easy to understand plans
- People have to pay low premium which can be affordable
- The plan can compensate for monetary losses covered under the plan
- The plan can help people in rural areas become independent

Check Your Progress

1. What is fire insurance?
2. What is Marine insurance?
3. What do you mean by Non-Life Insurance?
4. What is rural insurance

6.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. A fire insurance is an agreement between two parties, i.e., insurer and insured. The insurer undertakes to compensate for the loss or damage suffered by the insured in consideration of the insured paying certain sum called 'Premium'.
2. International trade has always relied heavily on sea routes for the transport of various kinds ever since ancient times. Ships have been a primary mode of business well before aeroplanes or trains were invented.

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3. Non-Life Insurance is a policy that provides compensation for losses incurred from a specific financial event. This type of policy is also known as general insurance, or property and casualty insurance. Examples of non-life insurance policies include automobile policies, home-owners policies, damage cover from fire, marine accidents, travel, theft and any catastrophe etc.
4. Rural insurance ensures that families living in rural areas have a safe and secure future so that they can lead a happy life. The insurance helps them to cover risks related to various aspects of their life. Rural Insurance policies come with the affordable premium rates and faster claim process.

6.6 SUMMARY

In this unit, you have learnt about the elements of fire insurance contract and its ancillary features, significance of marine insurance and its various policies and role of rural insurance in making people's lives better in rural in India. Protecting your business against fire-related outbreak is essential. Fire Insurance is the ideal protection plan to ensure optimum financial protection in case of a fire outbreak. The policy protects the insured building, assets, furniture and fixtures against a series of perils. The insured is reimbursed based on the market value of the property. Every entrepreneur or new business set-up should own fire insurance as it comes in handy in mitigating the aftermath of fire damage. As no property is resilient to fire or other natural disasters. The repercussion can lead to huge fragility if you're not backed by financially. At times, a small business may face huge financial hardship if not covered by insurance. Hence, Fire insurance can be a saviour in the event of privation. This policy gives more importance to the voyage. It covers all marine risks involved in a particular sea voyage irrespective of the time taken to accomplish the voyage. The insurance company pays the compensation if the insured property is damaged in the ship while traveling from one port to another.

Marine Insurance is an area which involves a lot of thought, straightforward and complex dealings in order to achieve the common ground of payment and receiving. But as much as complex the field is, it is nonetheless interesting and intriguing because it caters to a lot of people and offers a wide range of services and policies to facilitate easy and uncomplicated business transactions.

6.7 KEY WORDS

- **Cargo Insurance:** This kind of a marine insurance policy caters explicitly to a ship's cargo. However, this insurance also covers the belonging of the ship voyager.

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- **Freight Insurance:** This kind of marine insurance policy provides an additional layer of security to the merchant vessel's corporation for situations involving loss of cargo due to an unfortunate event.
- **Liability Insurance:** As the name of the policy indicates, the liability insurance offers compensation when a liability is sought due to a ship crash, collision or an attack.
- **Hull Insurance:** A Liability Insurance is chosen to ensure the protection of the torso and the hull of a vessel including the furniture and articles present within it.
- **Time Plan:** When a marine insurance policy plan is issued for a particular period, it is known as a Time Policy. Most commonly, this kind of policy is valid only for a specific period such as for one year.
- **Voyage Plan :**A Voyage Plan is a kind of marine insurance policy for those individuals who want to ensure a specific sea voyage
- **Port Risk Plan:** This marine insurance policy ensures the safety and security of a ship while it is anchored at a port.
- **Mixed Plan:** A Mixed Plan is a marine insurance policy that offers the benefits of the Voyage Plan and the Time Plan together.

6.8 FURTHER READINGS

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6.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

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Short Questions

1. What is fire insurance?
2. What is Marine insurance?
3. What do you mean by Non-Life Insurance
4. What is rural insurance
5. Define fire insurance contract
6. What is the meaning of fire in a fire insurance policy
7. What are the companies offering rural insurance in India

Big Questions

1. What are the Features of a fire insurance contract
2. Describe the different kinds of Marine insurance policies
3. Define Contract of Marine insurance. Explain briefly the various kinds of Marine Insurance Policies
4. Write short note on the following:
    a. Voyage policy
    b. Floating policy
    c. Wagering Policy
    d. Valued Policy
5. Explain the importance of marine policy
6. Define fire insurance contract. What are the characteristics of a fire insurance contract?
7. Explain the insurable interest in a fire policy
8. What Rural Insurance Covers?
9. What are the Types of Rural Insurance?
10. What are the Functions of Rural Insurance?

UNIT 7 NON-LIFE INSURANCE-II

NOTES

Structure

7.1 INTRODUCTION

Vehicle insurance (also known as car insurance, motor insurance, or auto insurance) is insurance for cars, trucks, motorcycles, and other road vehicles. Its primary use is to provide financial protection against physical damage or bodily injury resulting from traffic collisions and against liability that could also arise from incidents in a vehicle. Vehicle insurance may additionally offer financial protection against theft of the vehicle, and against damage to the vehicle sustained from events other than traffic collisions, such as keying, weather or natural disasters, and damage sustained by colliding with stationary objects. The specific terms of vehicle insurance vary with legal regulations in each region.

More popularly known as motor insurance, this type of insurance provides cover for loss or damage to any vehicle like car, two-wheeler or commercial vehicle, etc.

This insurance helps mitigate monetary harms due to accidents causing damage to the vehicles. The premium amounts that are payable by the person securing insurance for his vehicle depends on various factors like insured declared value, type of vehicle, age of vehicle, fuel type, age of the insured, etc. Liability insurance pays for damage to someone else's property or for injury to other persons resulting from an accident for which the insured is judged legally liable; collision insurance pays for damage to the insured car if it collides with another vehicle or object; comprehensive insurance pays for damage to the insured car resulting from fire or theft or many other causes; medical-payment insurance covers medical treatment for the policyholder and his passengers.

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According to the Insurance Information Institute, in the United States in the early 21st century, about two-thirds of the money spent on premiums for private passenger auto insurance went to claims. More than half of this amount covered car damage. The rest covered personal injuries. The remaining third of the money spent on premiums covered insurance companies' expenses such as commissions, dividends to policyholders, and company operations and contributed to their profits. In many countries, other approaches to automobile accident insurance have been tried. These include compulsory liability insurance on a no-fault basis and loss insurance (accident and property insurance) carried by the driver or owner on behalf of any potential victim, who would recover without regard to fault.

Most existing no-fault plans are limited in the sense that they usually permit the insured party to sue the party at fault for damages in excess of those covered by the plan and permit insuring companies to recover costs from each other according to decisions on liability. Total no-fault insurance, on the other hand, would not permit the insured to enter tort liability actions or the insurer to recover costs from another insurer.

Key Features of Motor Insurance

Some of the key features of motor insurance can be listed as follows.

- Most motor insurance policies protects you and your vehicle from all kinds of manmade and natural disasters.
- There are multiple add-on covers available to provide extra protection for your vehicle. Some of these rider policies can be extremely beneficial when it comes to vehicle maintenance.
- The premium charges for motor insurance is calculated based on the IDV of the vehicle. During the time of renewal, the IDV is calculated again based on the depreciation of the vehicle.
- Premium discounts can be enjoyed by vehicle owners by choosing a higher deductible. Deductible refers to the amount of money you are willing to pay from your own hand during a claim. Many insurers allow flexible options when it comes to choosing a deductible for your motor insurance policy.
- No claim bonus is available with most motor insurance policies. If no claims have been made during a particular policy period, policyholders can enjoy no claim bonus in the form of premium discounts.
- Cashless car insurance benefit is available in the select network of garages affiliated to the insurance company. When the vehicle is serviced in these garages, vehicle owners have to pay only for the deductible amount opted by them.
- Almost all major motor insurance service providers provide online services when it comes to paying premiums and filing for claims. With this benefit, getting an insurance cover is no longer a cumbersome activity.

7.2 TYPES OF MOTOR INSURANCE POLICIES

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Motor insurance is one of the primary financial protection tools that you should have in your possession. With the ever-increasing incidence of accidents in the country and the strict regulations laid out by the government, it is inevitable that you buy adequate insurance protection for your vehicle. There are various types of motor insurance policies available in the country. You should ideally assess your insurance requirements and decide on a policy that safeguards you in the most optimum way.

Motor insurance plans are classified into different categories based on the extent of coverage offered and the type of vehicle for which the insurance is sought.

Amount of insurance coverage: Motor insurance plans can be divided into three types based on the amount of insurance protection offered:

- **Third-party liability insurance** - This is the most basic form of car insurance and hence, it is also the cheapest. This insurance scheme is also referred to as liability-only insurance or act-only plan. The Motor Vehicles Act, 1988, mandates that all car owners are in possession of this insurance policy for the protection of their vehicles. In case you drive a car without a minimum of third-party liability insurance cover, you are liable to face penalties.
  - o The coverage offered by this insurance plan includes protection to a third party for incidents such as injuries/death and property damage caused in an accident involving the insured vehicle.
  - o It should be noted that the third-party liability insurance cover does not offer own-damage cover, i.e., coverage for the insured vehicle or the owner-driver.
  - o Some insurance companies offer a personal accident cover for the owner-driver along with the third-party liability insurance plan.
  - o Although there is no upper limit on the amount a third party can receive as compensation for death/disabilities, there is a cap of Rs.7.5 lakh on the maximum amount offered for third-party property damages. However, the final claim amount is decided by the court.

Comprehensive motor insurance: Often referred to as a package policy by some insurers, this plan provides more exhaustive insurance protection, as it encompasses third-party liability coverage and own-damage cover. The detailed coverage of the comprehensive motor insurance plan is as described below:

- **Own-damage cover** - This includes protection for the insured vehicle from the following events:
  - o Accidental damages
  - o Damages while in transit via rail, road, waterways, lift, etc.

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- o Damages caused by natural calamities, such as earthquakes, floods, hurricanes, etc.
- o Damages from man-made disasters such as strikes, riots, vandalism, etc.
- o Theft of the insured vehicle

Additionally, the comprehensive motor insurance plan offers personal accident cover to the owner-driver.

- **Third-party liability cover** - This part of the comprehensive motor insurance policy protects the policyholder from legal liabilities to a third party from accidental injuries/death or property damage. The maximum amount of coverage under this insurance for injuries/death is unlimited. However, there is a cap of Rs.7.5 lakh on coverage for third-party property damage. The final claim payout for property damage is decided by the court.

Motor insurance add-on plans: Apart from the comprehensive and third-party liability insurance plans detailed above, most motor insurance companies also offer add-on covers that can enhance the coverage of the base policy. These riders should be purchased from the same insurance provider by paying an additional amount. Some of these add-on plans are as described below:

- **Zero depreciation cover** - This is a popular motor insurance add-on plan that offers significant savings at the time of a claim. It is also referred to as nil depreciation cover or bumper to bumper policy. Consider that your vehicle is insured with a comprehensive motor insurance policy. At the time of a claim, you will still have to bear the expenses pertaining to depreciation of the vehicle parts and excesses. However, if your comprehensive motor insurance plan was reinforced with a nil depreciation cover, the insurer would bear the expenses for the depreciation of vehicle parts.
- **Engine protect cover** - A comprehensive motor insurance plan does not protect the vehicle from mechanical or electrical damages to the engine. Buying an engine protect cover offers your engine the much-needed protection, especially if you reside in an area prone to waterlogging.
- **Return to Invoice (RTI) cover** - This add-on plan protects your vehicle from total loss expenses. In the event of a total loss scenario such as a car theft, it provides you the actual invoice value of the vehicle, without accounting for its depreciation with age.
- **Loss of personal belongings cover** - Loss of expensive electronic equipments, laptops, etc. kept in the insured vehicle is offered coverage under this add-on insurance plan.
- **No Claim Bonus (NCB) protect cover** - No Claim Bonus is a significant bonus offered by insurers to drivers who refrain from raising motor insurance claims in a policy year. You can preserve this bonus even after raising a claim if your vehicle insurance has an NCB protect cover.

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- **Personal accident cover for the passengers** - The comprehensive car insurance policy can be enhanced to offer protection for the passengers by opting for this rider.
- **Key replacement cover** - Under this cover, the insurance company reimburses the cost of replacement of the vehicle keys if these were lost or misplaced.
- **Roadside assistance cover** - This add-on cover offers 24/7 protection to the policyholder from incidents such as flat tyre, fuel depletion, requirement for expert scrutiny, etc.
- **Consumables cover** - Components that are used in a vehicle such as nuts and bolts, screen washers, engine oil, etc. are collectively referred to as consumables. The insurance company does not bear the cost of these components at the time of a claim. However, if your vehicle insurance was equipped with this rider, you will receive coverage for consumables.
- **Daily allowance cover** - This add-on cover offers reimbursement for the expenses involved in hiring an alternate vehicle when the insured automobile is undergoing repairs at a garage.

Type of vehicle

Motor insurance policies can be classified into two types based on the vehicle for which it is purchased:

- This coverage offers insurance protection for all types of cars and SUVs.
- Two-wheeler insurance - This insurance plan is availed to protect a two-wheeler from eventualities such as accidents, natural disasters, theft, man-made calamities, etc.

Apart from the above, motor insurance is also segregated based on the purpose of use of the vehicle. So, you can opt to buy a private motor insurance policy for your personal vehicle. Along the same lines, a commercial motor insurance plan will offer insurance coverage for the vehicle you will be using for business purposes. In conclusion, motor insurance in India can be of several types. It is up to you to understand your unique insurance needs and decide on a policy that suits you best. It is also advisable to buy motor insurance online for the security and convenience that it offers.

7.3 CRITICAL ASPECTS OF AVIATION INDUSTRY IN THE COUNTRY

Aviation, or air transport, refers to the activities surrounding mechanical flight and the aircraft industry. Aircraft includes fixed-wing and rotary-wing types, morphable wings, wing-less lifting bodies, as well as lighter-than-air craft such as balloons and airships.

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One of the major highlights in 2015 for the global aviation sector will be the aviation reforms in India. This has been revealed by OAG, the Official Airline Guide, one of the market leaders in aviation intelligence, information and analytical services. The aviation sector is one of the fast growing sectors of Indian economy. Tony Tyler, Director-General and CEO of International Air Transport Association (IATA) has stated that the global world is focusing on Indian aviation, starting from manufacturers, businessmen, airlines, global businesses, tourism boards to individual travelers and shippers. According to him, if there is a common goal among all stakeholders in the aviation sector of India, a bright future can be expected.

Let us analyse the trends in the aviation sector and see what the emerging scenario like.

Market size

It has been reported that the air traffic in India has increased over the last five years both in terms of aircraft movement and passenger traffic. The compound annual growth rate (CAGR) of total aircraft movements was 3.3% and of passengers 5.6% during FY11 to FY14. In the next five years too, in terms of the aircraft movements, passengers and freights, the aviation sector is expected to grow, according to the Airports Authority of India (AAI). The job market in this sector is also expected to improve in 2015 with a number of new airlines coming up. Globally, it stands ninth in the civil aviation market. It ranks fourth in domestic passenger volume. It has been reported that by 2020 the civil aviation market in the country will become the world's third largest and is expected to be the largest by 2030. This sounds really good.

7.3.1. Factors contributing to the growth of the aviation sector

From an over-regulated and under-managed sector, the aviation industry in India has now changed to a more open, liberal and investment-friendly sector, especially after 2004. The civil aviation sector in India has moved into a new era of expansion. Some major factors contributing to this are:

- Higher household incomes
- Strong economic growth
- Entry of low cost carriers (LCC)
- Increased FDI inflows in domestic airlines
- Increased tourist inflow
- Surging cargo movement
- Cutting edge information technology (IT) interventions
- Focus on regional connectivity
- Modern airports
- Sustained business growth and
- Supporting Government policies

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Some major threats

- A global economic slowdown negatively impacts leisure, optional and business travel.
- The continuous rise in the price of fuel is a major threat.
- A terrorist attack anywhere in the world can negatively impact air travel.
- Government intervention can lead to new costly rules.
- Operation of many airlines

Problems facing the aviation sector

- High operational costs
- High cost of aviation turbine fuel
- High service tax and other charges
- Shortage of maintenance facilities
- High foreign exchange rate
- Competition from foreign airlines
- Congestion at airports
- Lack of qualified pilots and technical manpower etc.

Six new airlines to start operations in 2015

Civil aviation minister Ashok Gajapathi Raju said that in 2015, six airlines would start operations. There is no threat in launching of new airlines even if most of the airlines are reported to have incurred losses and a few are struggling to stay afloat. Even while, the state of the existing domestic airlines is not impressive in the sense that a few of them remain in debt, aviation professionals and investors are not hesitating launching new airlines on regional and pan-India routes.

The seven major airlines that India has at present are Air India, IndiGo, Jet Airways, SpiceJet, GoAir, Air Costa and AirAsia India, in which around 60 million domestic passengers travel annually. In 2014, we saw the launch of AirAsia India. AirAsia is the first foreign airline to set up a subsidiary in India and is an Indo-Malaysian low cost carrier. In 2015, the first new airline to take off is Vistara, based in New Delhi. It commenced operations on January 9, 2015. This Indian airline, a joint venture between Tata Sons and Singapore Airlines, operates 14 daily flights with three Airbus A320 aircraft. Among other start-ups preparing for launch are Air Pegasus, Air One, Flyeasy, Premier Airways. Air Pegasus is promoted by Bangalore-based ground handling firm Deccor Aviation, Air One runs charter services, Flyeasy will be a regional airline with Bangalore as its base, and Premier Airways will headed by NRI engineer Umapathy Pinaghapani and slated to launch in mid 2015.

Opportunities

Indian aviation space offers promising opportunities in the areas of

- Aircraft manufacturing
- Airport infrastructure
- Airport and ground support equipment
- Maintenance Repair Operations (MRO) facilities
- Ground handling services
- Trained manpower
- Air cargo and fuel hedging etc.

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The launching of the new airlines can be an aviation boom in the country as it will lead to an increase in the number of flights, lower prices, more demand for ground staff and trained crew, including a rise in finance and leasing activities. However, the real challenge of the Indian aviation industry is to manage the unprecedented growth of air traffic with safety. The increase in air traffic has raised the demand for aircrafts. But at the same time, it has also posed a problem of modernising the airport and air navigation infrastructure so that safe, efficient and orderly operations are ensured. There is an urgent need to study the causes of the issues and address them so as not to obstruct the growth path of the aviation sector.

And we should remember that even today, access to aviation is still a distant dream for the poor and the lower middle class sections of its vast population. So there is a large untapped potential for growth in the industry as well. It is necessary for the stakeholders to engage and collaborate with the policy-makers to implement efficient and rational decisions that will shape the future of the aviation industry. With the right policies and a continued focus on cost, quality and passenger interests, India would definitely be able to realize its vision of becoming the third largest aviation market by 2020.

7.4 SIGNIFICANCE OF LIABILITY INSURANCE IN INDIA

Liability insurance is a policy that offers protection to businesses and individuals from risk that they may be held legally or sued for negligence, malpractice or injury. This insurance policy protects the insured from legal payouts and costs for which the policyholder is deemed to be responsible. The necessity for insurance today is paramount and this is due to the fact that we live in an economically uncertain world and one never knows when financial help is required. Insurance acts as a safety blanket and protects customers from various issues that may arise. Insurance plans are of various types based on the requirement. The most commonly acquire policies are Life Insurance policies, Health Insurance Policies, among others.

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However, there are other insurance policies that are quite specific in nature and correspond to certain unique requirements. These types of policies are procured by customers who require cover only for certain issues and not for generic ones life and health. One of this is the Liability Insurance.

Liability Insurance Overview

Liability insurance is a policy that offers protection to businesses and individuals from risk that they may be held legally or sued for negligence, malpractice or injury. This insurance policy protects the insured from legal payouts and costs for which the policyholder is deemed to be responsible. However, contractual liabilities and intentional damage are usually not covered as part of this policy.

This policy was originally created by companies or individuals who experienced common risks and hence created a fund to help pay for each other's issues regarding this. These policies offer cover against their party claims as the payment will not be for the insured to the person who has been affected by the damage caused. In case a claim is made then the policy provider will have to defend the policyholder.

Why is Liability Insurance Required?

This type of an insurance policy is generally procured by companies or individuals who may be held liable, legally for injuries or other issues. This especially the case for hospitals, doctors or even business owners. An example would be, if a product manufacturer sells products that have been faulty or causes damage to other's products, then he/she may be sued for the damages caused. Procuring a liability insurance will cover the manufacturer from ensuing legal costs.

Liability insurance is one part of the general insurance policy itself under the risk transference category. In many countries, liability insurance is mandatory especially for drivers of public transport vehicles. The scope of this form of insurance in India has been defined by the Public Liability Insurance Act of 1991.

7.4.1. Types of Liability Insurance Plan

There are number of liability insurance policies available for customers based on their line of work and requirements. The most common forms of Liability insurance are Public, Product, Employers and Third-party liability.

- **Public Liability Insurance** : Although only certain countries have made this type of an insurance mandatory, most industries, especially those that have an affect on third parties such as visitors, trespassers, etc. Regardless of whether it is mandatory or not, most companies procure it so as to avoid unnecessary risk. Certain small industries do not procure liability insurance policies as the premium is quite high, however, in the event of any claims, the legal costs will usually outweigh the premium costs. Therefore, procuring this policy is usually more prudent. This risk increases exponentially when these locations are shopping centres, theatres, clubs etc and areas where

sporting events are held and places that allow consumption of alcohol. In cases where the risk is extremely high, policy providers either refuse to insure these liabilities or charge an exorbitant premium.

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- **Product Liability:** This is again not a compulsory insurance requirement in many countries, but it is highly important. This is procured by companies whose products are widely used such as chemicals, tobacco, medical products, food, recreational products and others.
- **Employer Liability:** This type offers cover to liabilities that an employer may incur if an employee is injured during his/her employment due to the job. Sometimes, companies do not deem this as important but if faced with a claim, they might be driven to bankruptcy.
- **Third-Party Liability**: This policy covers damages caused by the insured to another. The insured is considered as the first party, the insurance company is the second and the third is the injured or the person/company making the claims.
- **How is the Premium Amount Decided?** The premium that is to be paid by the insured will be worked out using the base rate based on the insurance company's needs and assessments. Another factor that is taken into consideration is the amount of risk that the company and its products come with. Higher the risk, higher is the premium to be paid. Claim history, size of the risk and the company's approach to the risk are additional factors. While deciding the premium amount, insurance companies take into consideration the environment, number of claims made previously and their business record.

Companies Providing Liability Insurance Policy

There are a number of companies within India that provide different forms of liability insurance covers. Some of these are –

- **HDFC** Ergo Commercial General Liability - this insurance policy provides protection against claims of property damage or bodily injury for which the company is liable.
- **ICICI** Lombard offers numerous liabilities insurance covers to suit business requirements.
- **Bharti AXA** Commercial General Liability Policy offers cover for liabilities that are a result of business processes and operations.
- **TATA AIG** offers a Commercial General Liability Insurance Policy that covers third party liabilities that are a result of business operations.

7.4.2. Importance of Liability Insurance

Liability insurance covers a person or company from meeting third-party claims. As a result, any business and people who transact on areas prone to accidents

should buy this Policy or else, remain at the Risk of meeting claims whenever an Accident happens within their places of work.

Meeting such accident claims often results in financial losses and lost income which is detrimental to a person's or business financial growth. Usually, liability insurance is offered based on the potential risk to individuals and businesses. Following are the types of policies offered under liability insurance in India:

General Liability

General Liability is a liability insurance policy which covers businesses from a number of lawsuits that may be linked to their: products, services, and normal transactions. Among the risks covered by this policy include injury to shoppers, product defects, property damage and negligence on employees' part. The insurance policy will prevent you from meeting many types of expenses like legal fee and medical expenses. With this policy in place, you don't need to waste your time guarding against that which you can't prevent. You are already protected. Although general liability is a more comprehensive insurance policy, a company can opt to have individual policies put in place to take care of risk-prone areas. For instance, getting a public liability policy can be of benefit to companies that are likely to experience a lot of human traffic accessing their premises. If an accident happens, the company will have the damages incurred covered by the policy. Companies that deal with goods should consider getting a product liability policy before venturing into the market. In the event that the goods in question get linked to unfavorable incidences, consumers who know their right opt to file lawsuits as a gateway to their eventual compensation. When this happens, the product liability policy provider will come in to settle expenses that may arise from the compensation agreed upon.

Professional Liability

Just as the name suggests, professional liability is aimed at protecting professionals during their course of operations. Among the professionals that can be covered include consultants, physicians, and lawyers. Errors of commission and omissions are very expensive to meet especially when a disgruntled client wins a lawsuit against the professional. This policy safeguards against loses associated with property damage, investigation expenditure, medical expenses, and other likely costs.

Worker's Compensation

The main reason behind having workers compensation policy is to safeguard employees' needs and wants. The policy covers most of the risks likely to happen in a particular job setting. In the event that any employee suffers any injury, work-related illness and loss of income, in line of duty, this policy comes in handy by reinstating him or her to the previous state. Most countries have passed laws requiring companies and different kinds of business to get workers compensation policy for every employee they take up.

Liability Insurance Claim Process

The claims process varies from one company to the other. There is generally a form to be filled for the same post which all necessary documents will have to be provided. However, when it comes to liabilities it is not as simple. There may be court cases or an out-of-court settlement. The claims process will be different based on what the claim is being made for.

Check Your Progress

1. What Do you understand by motor vehicle insurance?
2. Write short note on Third-party liability insurance.
3. What is meant by Comprehensive policy?
4. What do you understand by Liability Insurance
5. Why is Liability Insurance Required?

7.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. Vehicle insurance (also known as car insurance, motor insurance, or auto insurance) is insurance for cars, trucks, motorcycles, and other road vehicles.
2. This insurance scheme is also referred to as liability-only insurance or act-only plan. The Motor Vehicles Act, 1988, mandates that all car owners are in possession of this insurance policy for the protection of their vehicles. In case you drive a car without a minimum of third-party liability insurance cover, you are liable to face penalties.
3. A package policy by some insurers, this plan provides more exhaustive insurance protection, as it encompasses third-party liability coverage and own-damage cover.
4. Liability insurance is a policy that offers protection to businesses and individuals from risk that they may be held legally or sued for negligence, malpractice or injury.
5. An insurance policy is generally procured by companies or individuals who may be held liable, legally for injuries or other issues. This especially the case for hospitals, doctors or even business owners

7.6 SUMMARY

In this unit, you have learnt about the introduction of motor insurance policies, types of motor insurance policies, critical aspects of aviation industry and significance of liability insurance in India. This insurance helps mitigate monetary harms due to

accidents causing damage to the vehicles. The premium amounts that are payable by the person securing insurance for his vehicle depends on various factors like insured declared value, type of vehicle, age of vehicle, fuel type, age of the insured, etc. Liability insurance pays for damage to someone else's property or for injury to other persons resulting from an accident for which the insured is judged legally liable; collision insurance pays for damage to the insured car if it collides with another vehicle or object; comprehensive insurance pays for damage to the insured car resulting from fire or theft or many other causes; medical-payment insurance covers medical treatment for the policyholder and his passengers.

7.7 KEY WORDS

- **Zero depreciation cover:** It is also referred to as nil depreciation cover or bumper to bumper policy. Consider that your vehicle is insured with a comprehensive motor insurance policy.
- **Workers Compensation :** workers compensation policy is to safeguard employees' needs and wants
- **Product Liability:** Companies whose products are widely used such as chemicals, tobacco, medical products, food, recreational products and others.
- **Employer Liability:** An employer may incur if an employee is injured during his/her employment due to the job.

7.8 FURTHER READINGS

1. **P.K.Gupta (2016).** Essentials of insurance and risk management, Himalaya Publishing House, New Delhi
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7.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. What do you understand by motor vehicle insurance?
2. Write short note on Third-party liability insurance
3. What is meant by Comprehensive policy?
4. What do you understand by Liability Insurance?
5. Why is Liability Insurance Required?

Big Questions

1. Explain the special features of motor vehicle insurance
2. Write about the types of motor insurance policies?
3. What are the risks covered under motor insurance?
4. Explain the procedure of effecting motor insurance
5. What are the factors contributing to the growth of the aviation sector?
6. What are the importance of Liability Insurance?
7. Explain the types of Liability Insurance Plan.

UNIT 8 FUNCTIONS AND ORGANIZATION OF INSURERS

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Structure

8.1 INTRODUCTION

Insurers perform a series of functions, many of them really important roles in our society. The key role of insurers is to help their policyholders manage risk efficiently through providing insurance products, and paying the claims covered by their insurance policies. There are no certainties or guarantees in life. There is no guarantee that the business will not suffer an unexpected loss or damages. So while we cannot protect our interests against all risks, we can opt for some insurance. Let us take a look at concepts of insurance and functions of an insurance company.

Insurance is defined as a contract, which is called a policy, in which an individual or organisation receives financial protection and reimbursement of damages from the insurer or the insurance company. At a very basic level, it is some form of protection from any possible financial losses. The basic principle of insurance is that an entity will choose to spend small periodic amounts of money against a possibility of a huge unexpected loss. Basically, all the policyholder pool their risks together. Any loss that they suffer will be paid out of their premiums which they pay.

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8.1.1. Functions of Insurers

The functions performed by any insurer necessarily depend on

- The type of business it writes, the degree to which it has shifted certain duties to others, the financial resources available, the size of the insurer, the type of organization used, etc.

These functions, which are normally the responsibility of definite departments or divisions within the firm, are

- Production
- Underwriting
- Rate making
- Managing claims and losses
- Investing and financing

Such as legal advice, marketing research, engineering, and personnel management

Production

One of the most vital needs of an insurance firm Is securing a sufficient number of applicants for insurance to enable the company to operate Often called production in the context of the insurance industry Corresponds to the sales or marketing function in an industrial firm This is a proper term for insurance because the act of selling is production in its true sense Insurance is an intangible item and does not exist until a policy is sold.

The production department of an insurance company, sometimes called the agency department, is its sales or marketing division. This department supervises the external portion of the sales effort, which is conducted by the agents or salaried representatives of the company. The internal portion of the production function is carried on by the production (or agency) department. It is the responsibility of this department to select and appoint agents and assist in sales. In general, it renders assistance to agents in technical matters. Special agents, or people in the field, assist the agent directly in marketing problems. The special agent is a technician who calls on agents, acting as an intermediary between the production department and the agent. This person renders assistance when needed on rating and programming insurance coverages and attempts to encourage the producers.

Underwriting

Includes all the activities necessary to select risks offered to the insurer in such a manner that general company objectives are filled In life insurance, underwriting is performed by home or regional office personnel Who scrutinize applications for coverage and make decisions as to whether they will be accepted And by agents, who produce the applications initially in the field In the property-liability insurance area agents can make binding decisions in the field But these decisions may be

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subject to post under writing at a higher level because the contracts are cancelable on due notice to the insured In life insurance, agents seldom have authority to make binding underwriting decisions In all fields of insurance, agency personnel usually do considerable screening of risks before submitting them to home office underwriters.

Rate making

An insurance rate is the price per unit of insurance. Like any other price, it is a function of the cost of production. However, in insurance, unlike in other industries, the cost of production is unknown when the contract is sold, and it will remain unknown until sometime in the future when the policy has expired. One fundamental difference between insurance pricing and the pricing function in other industries is that the price for insurance must be based on a prediction. The process of predicting future losses and future expenses and allocating these costs among the various classes of insured's is called ratemaking.

A second important difference between the pricing of insurance and pricing in other industries arises from insurance rates being subject to government regulation. As we noted in the preceding chapter, nearly all states impose statutory restraints on insurance rates. State laws require that insurance rates must not be excessive, must be adequate, and may not be unfairly discriminatory. Depending on the manner in which the state laws are administered, they impose differing limits on an insurer's freedom to price its products.

The ratemaking function in a life insurance company is performed by the actuarial department or in smaller companies, by an actuarial consulting firm. In the property and liability field, advisory organizations accumulate loss statistics and compute loss costs for use by insurers in computing final rates, although some large insurers maintain their own loss statistics. In the field of marine insurance and inland marine insurance, rates are often made by the underwriter on a judgment basis.

In addition to the statutory requirements that rates must be adequate, not excessive, and not unfairly discriminatory, other characteristics are considered desirable. To the extent possible, for example, rates should be relatively stable over time, so the public is not subjected to wide variations in cost from year to year. At the same time, rates should be sufficiently responsive to changing conditions to avoid inadequacies in the event of deteriorating loss experience. Finally, whenever possible, the rate should provide some incentive for the insured to prevent loss.

Managing claims and losses

The premium is designed to cover two major costs The expected loss, or the pure premium Determined by dividing the total expected loss by the number of exposures The cost of doing business, or the loading Such items as agents' commissions, general company expenses, premiums, taxes and fees, and allowance for profit The sum of the pure premium and loading is termed the gross premium The loading

is usually expressed as a percentage of the expected gross premium The pure premium is the estimate of loss cost The ratio of the loss cost to the gross premium is called the loss ratio.

Investing and financing

The basic rate-making method used in property-liability insurance Does not make a direct allowance for investment income to be earned on policyholders' funds held by the insurer until they must be paid out as losses In life insurance, an allowance is made for a minimum assumed rate of return on policyholders' funds From the 1950s through the early 1980s, a steady rise occurred in interest rates in the United States Even the decline at the end of the 1980s still left long-term interest rates at near record levels Given this increase in interest rates, policyholders and regulators demanded that some recognition be given to the investment income factor in ratemaking Especially in those lines of insurance that have a long payout period Insurers rarely make an underwriting profit in these lines because they rely on investment income for part of their profit Underwriting + investment revenue - expenses = profit.

Because a portion of their invested funds must go to meet future claims, the primary requisite of insurance company investments is safety of principal. In addition, the return earned on investment is an important variable in the rating process: Life insurance companies assume some minimum rate of interest earnings in their premium computations. Increasingly, property and liability insurers are required to include investment income in their rate calculations. It may be argued that even when investment income is not explicitly recognized, it subsidizes the underwriting experience and is, therefore, a factor in ratemaking in this field.

8.2 COMPONENTS OF THE DISTRIBUTION SYSTEM OF LIFE INSURANCE COMPANIES IN THE COUNTRY

This unit deals with the various aspects related to emergence of different distribution channels after privatization of life insurance sector with a major focus on the role of traditional distribution channels in insurance, emerging distribution channels which are already in the adoption stream and ones to be adopted. Distribution channels are the drivers which extends services to satisfy the demands of thousands of customers. This chapter also looks at channel-wise performance of these in order to create a platform of success for life insurance companies. When trying to achieve the objective of this research, growth and financial analysis of distribution channels on life insurance companies' perspective was done and it was discovered that both public sector insurer and private sector life insurance companies have adopted

different channels of distribution to deliver products and services to customers and it was revealed that growth of channels is upwards which shows prospects of distribution channels success in future.

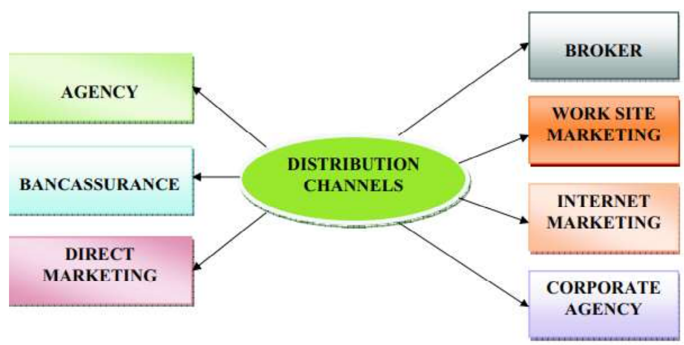
8.2.1. Distribution Scenario in the Indian Market

In today's Indian Insurance market, the challenge to insurers and intermediaries is two-pronged:

- Building faith about the company in the mind of the client
- Intermediaries being able to build personal credibility with the clients

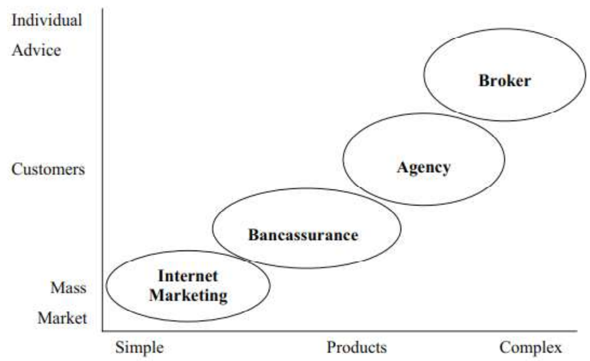
Prior to privatization, the only public sector insurer LIC was having the monopoly in insurance sector. LIC was having its branches in almost all parts of the country and it attracted people local people to become their agents. Traditionally, tied agents had been the primary channel of insurance distribution in the Indian market. The agents are from various segments in society and collectively cover the entire spectrum of society. Of course, the profile of the people who acted as agents, may not have been sufficiently knowledgeable about the different products offered and may not have sold the best possible product to the client. Nonetheless, the customer trusted the agent and company. This arrangement worked adequately in the absence of competition.

In today's scenario, life insurance companies have adopted different channels for distributing their products. A broad categorization of channels currently being used in the distribution of life insurance products is presented in Figure 8.1



Life Insurance companies have to provide servicing capabilities for the process of sale, kind of products and demand of the customers as it differs significantly among different distribution channels. This phenomena is explained in Figure 8.2. Which shows that internet marketing does not involve direct interaction with the customer and simple product will be suitable for the mass market segment. Figure 8.2 further indicates that agency channel helps customers to plan their financial requirements by personally interacting with them.

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Source: www.shodhganga.inflibnet.ac.in

Bancassurance channel provides the same platform for banking and insurance services. The customers are provided with well trained staff to access and plan their financial security. It is further indicated that brokers play the role of one stop shop by providing choice to the customers to make comparative analysis of insurance policies of different life insurance companies and they provide the best suitable plan according to the demand of the customer.

However, there is great excitement in the industry over the impending regulations and companies are planning possible channels in their network to increase volumes. The new companies have attempted appealing only to the middle, upper middle and elite classes in the major cities. Contrasted with Life Insurance Corporation of India and its offices across the country, the new companies have miles to go before they reach anywhere. Both Life Insurance Corporation and private sector companies are fighting their own battles from the perspective of customer perception management.

8.2.2 Distribution Strategies of Life Insurance Companies

This part arrangements with the different competitive distribution strategies opted by different life insurance players. As the competition increased by entry of number of players, the different insurers had to opt competitive distribution strategies in order to sustain in the market. So, in this distribution strategies adopted by the players are discussed in detail. A strong marketing strategy underpins the business objectives, by focusing on marketing activity in line with business strategy. Without a cohesive distribution strategy, the decisions made around concerned areas by companies can be ad hoc, fragmented and can lose effect.

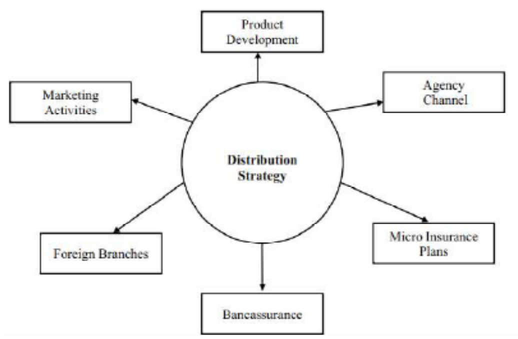
Insurance companies adopt the marketing strategy which results in mobilizing and utilizing its invisible assets, which will enable the companies to:

- Develop customer relationship that retains the loyalty of existing customers and enable new customer segment and market areas to be served effectively and efficiently.
- Introduce new innovative products and services desired by targeted customer segment.

- Produce customized high quality products and services at low cost and with short lead times.
- Mobilize employee skills and motivation for continuous improvements in process capabilities, quality and response times.
- Deploy information technology, data bases and systems in an optimum manner.

The market strategy cannot be taken up in isolation. Major elements of the organization, viz., structure, systems, processes, employees, organizational cultures and above all the shared values should be appropriately integrated in implementation of the strategy. The basis tool for diagnosing competitive advantages and finding ways to enhance is to enhance its value chain, which divides a company into discrete activities it performs is designing, producing, marketing and distributing its products.

Figure 5.1
Distribution Strategy Model of LIC



LIC, being oldest insurer and Govt. owned insurer in the market. Its market share is large as compared to private players. But consumers' perception of the insurance is that of an investment rather than as a risk cover. They expect prompt services. LIC has been facing competition pressure, so it has been reorganizing itself in order to perform better and to compete with private players. LIC has been formulating new strategies and plans from time to time. No doubt, experience generally improves performance, the LIC has experience of more than fifty years. Even IRDA also aims at innovative and progressive development of insurance sector. LIC has following steps to increase its market competitiveness and retains its dominant position in the insurance market:

Product development

Life Insurance Corporation introduced traditional insurance schemes. To cater consumers' needs about protection against risk factor, provision of future, old age provision, by launching whole life plans, endowment plans, term insurance plans and pensions plans over a period. Every year by taking market review, it introduces new innovative plans and also withdraw those plans which have less market response.

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Now, LIC of India has been changed its products to meet the varied need of the customers. It has been caused due to following reasons.

a. Competitive pressure
b. Changing behaviour of consumer

In the competitive market there is a greater need to provide insurance products that meet the needs of the customers. Therefore, LIC offers wide variety of products which fulfills the needs of different segments of the society. As at the end of financial years 2011-12 the corporation had 52 plans available for sale. During the year corporation had introduced 6 new plans viz Money plus-1, Market plus-1, Jeevan Bharti-1, Child Fortune plus and two term insurance plans i.e. Jeevan Astha and Jeevan varsha.

Marketing Activities

In marketing of insurance products effectively, field personnel play pivotal role. The corporation has developed alternative distribution channels along with existing channels to increase its business volume which are discussed as follows:

Agents

In LIC of India, the Agent is a pioneer field force, in procurement of the LIC's business. In the year 2011-12 total number of agents was 13,44,856. The corporation has launched scheme of urban career agents and rural career agents. To promote them, the corporation also gives stipends at the start of their career and to enable them to settle down in their profession.

Bancassurance and Alternate channels

LIC also tied up with the banks in urban and with Regional Rural Banks (RRB) to spread its business. The percentage share of alternate channel business to total business went up from 2.01% to 2.40% in policies and from 1.84% to 3.05% in first premium income. Out of total business of alternate channels, banks (under corporate agency mode) contributed 67.29% of number of policies and 63.70%.

Foreign Branches

The corporation directly operates through its branch offices in Mauritius at Port Louis, Fiji at Surva and Lautoka and United Kingdom at werobley. During the year 2007-08 these three foreign branches together issued 10.477 policies with sum assured of US $ 97.7 million at FPI of US million.

Micro Insurance Plan

The LIC of India, not only concentrates on celebrity marketing and rich class segment but also launched insurance plan under a separate business vertical to extend security to the less privileged section of the society under business vertical 'Jeevan Madhur' plan was launched in Sept. 2006 by the LIC.

8.3 ROLE OF AGENTS IN THE LIFE INSURANCE SECTOR IN INDIA

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Insurance plays an important role in sharing the risks of people in an affordable form. In India, life insurance is generally considered as a tax-saving device instead of its other implied long term financial benefits. An agent in law is one who acts for another and insurance agent is one who works for an insurer.

Life insurance is defined as "the device of providing for life after death and financial independence for those retired, disabled or who live longer". Man is exposed to risks and uncertainties. For instance, the time of death of a person is not certain and in the case of his premature death a man's dependents may find themselves deprived of all means of existence. Every prudent man will carefully consider how best he can prevent such risk or minimize or provide against its effects. It is difficult for an individual to survive unless the arrangement for covering the risks is possible. This arrangement is made possible by insurance.

In India, life insurance is generally considered as a tax-saving device instead of its other implied long term financial benefits. Indian people are prone to investing in properties and gold followed by bank deposits. They selectively invest in shares also but the percentage is very small. Even to this day, Life Insurance Corporation of India dominates Indian insurance sector.

8.3.1. Agents' personal development

Agents like every other individual do have personal goals and ambitions for example, to achieve some senior position in the company. An agent also aims to establish good reputation in the society and is willing to accept higher responsibilities and challenges of the institution. All such personal objectives and benefits in terms of self-interests and the interests of the company need to balance, with the interests of the customers, so as to have meaningful and long lasting result oriented impact on business and growth.

An agent has to sell himself before selling his product of life insurance. This is due to the intangible nature of the products and its long-term commitment. So, trust and belief in the customer is to be created for buying this product, which also needs to be sustained and continued in future too.

A customer buys because he trusts the agent and his promise. So, agent needs to adopt a positive and helping attitude so as not to let down the expectations of the customer. An agent needs to be enthusiastic, optimistic, convincing, and committed. With such high standards in these traits, an insurance agent can face the present market competition confidently.

An agent has to understand his customer and his needs, then communicate with him at horizontal platform. It needs to be effective and meaningful and palatable to customer. It should neither be confusing or incomplete nor suppressive or misleading. It must not lead to any misunderstanding. The common seven Cs of an

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effective communication like: completeness, correctness, courtesy, conciseness and consideration need to be followed strictly.

Adequate product knowledge is most important in present day competitive world. An agent needs to be well conversant and updated with his product knowledge besides premium ratings, terms and conditions, policy clauses etc. An agent is also expected to know the drawbacks and implications of the product and plan. Having good knowledge of all the products of his particular insurance company is equally important to be a successful agent.

As a true businessman, an agent must have his sales target, premium target, commission income target, revenue target and finally profit target to serve the purpose of himself, company, project and customer. Over a period of time, clients need to be added up and volume of business increased, so as to achieve the set goals and develop business objectives.

An insurance agent having specialized knowledge is a master businessman. As a professional, he has to watch the interests of his customers at the cost of his personal interests and gains. There must be no conflict and clash between these two parameters. Customer has right to know about the product and service, right to choose and select but his interests must always be above all. Also, both company and the agent are to protect the interest of their policy holders as per the law. An agent has to strive for building long-term relationship with his customers for survival and sustainability in the market. It can be mainly achieved by making the customers feel important, recognized, through a caring and helping attitude, courteous behaviour etc. Listening and understanding the customer is important and the concept of "your customer is always right" is most important for building long term relationship.

The agent before offering any product must know his clients well enough. He must have the knowledge about the state of client's personal habits, health, occupation, financial position and income, moral character, his family history and all other related aspects which help in field underwriting of a case. After accumulating the needed data/information, if the life is apparently found insurable, only in such a case, proposal should be procured.

In the present age of information, explosion, competition and the service industry like LIC, Insurance companies cannot survive without an action based philosophy of excellence after sales service. After sales service in an insurance industry includes collection of premia, revival / reinstatement of paid up / lapsed policies, nomination and assignment, grant of loan, payment of survival benefits, settlement of surrender value, alteration and finally the settlement of claims (death or maturity) under a policy and an agent can render invaluable help to his clients in these areas.

If the agents are well conversant with the claim settlement procedure and assist the claimants in completing the necessary requirements, it would not only quicken the process of claim settlement and enhance their professional status but

also help the organization to improve upon their outstanding claim ratio. Boosting the image of the organization may provide them an overflowing fountain for further business in those families.

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8.3.2. Role of agents

An agent in law is one who acts for another and insurance agent is one who works for an insurer. His job is to bring in customers for the insurance company and is remunerated in the form of commission expressed as a percentage of the premium payable on the business introduced. The rates of commission payable to an agent would normally depend on market competition and the volume and profitability of business procured by the agent concerned. In India, the rates of commission payable are stipulated under the insurance law and no commission is payable for insurance of firms having paid up capital in excess of the amount stipulated.

A critical element of insurance sector reforms is the development of resources having the right skills and expertise in each segment of the industry so as to provide quality intermediation to market participants. The number of agents with LIC as at 31st March 2007 was 11,03,047, while the private sectors had 8,90,152 agents. However, while the net increase in number of agents of LIC was 5 per cent, the private sector numbers increased by 140 per cent in the year 2006-07. The agency network has spread over all the states; however, the number of agents per 1000 population has varied across the states. At the national level, only 2 agents serve 1000 people. Chandigarh has 20 as against the national average of 2. The density of agents in states such as Goa, Kerala and Delhi is way ahead of the national average, while in the north eastern states other than Assam it is far below the national average. The presence of agents is well below the national average in the four populous states of Uttar Pradesh, Bihar, Madhya Pradesh and Rajasthan. It is worthwhile to mention here that the agency presence of private sector has overtaken that of LIC in states such as Gujarat, Haryana, Jammu and Kashmir, Kerala, Orissa, Punjab, Chandigarh and Delhi.

An agent is a primary source for procurement of insurance business and as such his role is the corner stone for building a solid edifice of any life insurance organization. To effect a good quality of life insurance sale, an agent must be equipped with technical aspects of insurance knowledge, he must possess analytical ability to analyze human needs, he must be abreast with up to date knowledge of merits or demerits of other instruments of investment available in the financial market, he must be endowed with a burning desire of social service and over and above all this, he must possess and develop an undeterred determination to succeed as a Life Insurance Salesman. In short he must be an agent with professional approach in life insurance salesmanship

8.3.3. Role of agents under IRDA regulation

Full information must be provided to the proponent at the point of sale to enable him to decide on the best cover or plan to minimize instances of 'cooling off' by the proponents.

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- An agent should be well versed in all the plans, the selling points and also be equipped to assess the needs of the clients.
- Adherence to the prescribed code of conduct for agents is of crucial importance. Agents must, therefore, familiarize themselves with provisions of the code of conduct.
- Agents must provide the office with the accurate information about the prospect for a fair assessment of the risk involved. The agents' confidential report must, therefore, be completed very carefully.
- Agents must also possess adequate knowledge of policy servicing and claim settlement procedures so that the policy holders can be guided correctly.
- Submission of proposal forms and proposal deposit to the branch office immediately to avoid delays and to enable the office to take timely decisions.
- A leaflet or brochure containing relevant features of the plan that is being sold should be available with the agents.

8.4 IMPORTANT ACTIVITIES CARRIED OUT IN A LIFE INSURANCE ORGANIZATION

The Life Insurance Corporation of India (LIC) came into existence on July 1, 1956 and the LIC began to function on September 1, 1956.

The LIC gets a large amount of insurance premium and has been investing in almost all sectors of the economy, viz, public sector, private sector, co-operative sector, Joint Sector and now it is one of the biggest term-lending institutions in the country. LIC was established to spread the message of Life Insurance in the country and mobilize people's savings for nation-building activities.

8.4.1. Organization and Management

LIC with its central office in Mumbai and seven Zonal offices at Mumbai, Kolkata, Delhi, Chennai Hyderabad, Kanpur and Bhopal operates through 100 divisional offices in important cities and 2048 branch offices. As on March 31, 2003 LIC had 9.88 lakh agents spread over the country. LIC also entered the international insurance market and opened its offices in England, Mauritius and Fiji.

8.4.2. Objectives of LIC

The important objectives of LIC are as follows:

- To mobilise maximum savings of the people by making insured savings more attractive.
- To extend the sphere of life insurance and to cover every person eligible for insurance under insurance umbrella.

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- To act as trustees of the insured public in their individual and collective capacities.
- Promote all employees and agents of the LIC, in the sense of participation and job satisfaction through discharge of their duties with dedication towards achievement of LIC objectives.
- To ensure economic use of resources collected from policy holders.
- To conduct business with utmost economy and with the full realization that the money belong to the policy holders.

8.4.3. Activities of LIC

The LIC subscribes to and underwrites the shares, bonds and debentures of several financial corporations and companies and grants term-loans. It maintains a relationship with other financial institutions such as IDBI, UTI, IFCI, etc. for coordination of its investment.

The LIC is a powerful factor in the securities market in India. It subscribes to the share capital of companies, both preference and equity and also to debentures and bonds. Its shareholding extends to a majority of large and medium sized non-financial companies and is significant in size.

It is no doubt to say that the LIC acts as a kind of downward stabilizer of the share market, as the continuous inflow of fresh funds enables it to buy even when the share market is weak.

8.4.4. Investment Policy

The investment policy of the LIC of India should bring a fair return to policy holders consistent with safety. Since the funds at the disposal of the LIC are in the nature of the trust money, they should be invested in such securities which do not diminish in value and give the highest possible return.

In other words, principles of safety, yield, liquidity and distribution should be taken into consideration while investing insurance funds. The way in which these funds are invested is a great significance not only to policy holders but also to the entire economy.

Check Your Progress

1. Define insurer.
2. Define Insurance.
3. What are the Underwriting?
4. What is meant by Rate making?
5. Who is insurance agent?

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8.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. Insurers perform a series of functions, many of them really important roles in our society. The key role of insurers is to help their policyholders manage risk efficiently through providing insurance products, and paying the claims covered by their insurance policies.
2. Insurance is defined as a contract, which is called a policy, in which an individual or organisation receives financial protection and reimbursement of damages from the insurer or the insurance company
3. The contracts are cancelable on due notice to the insured In life insurance, agents seldom have authority to make binding underwriting decisions In all fields of insurance, agency personnel usually do considerable screening of risks before submitting them to home office underwriters.
4. An insurance rate is the price per unit of insurance. Like any other price, it is a function of the cost of production.
5. Insurance plays an important role in sharing the risks of people in an affordable form. In India, life insurance is generally considered as a tax-saving device instead of its other implied long term financial benefits. An agent in law is one who acts for another and insurance agent is one who works for an insurer.

8.6 SUMMARY

In this unit, you have learnt about the functions and organization of insurers, components of the distribution system of life insurance companies, role of agents in the life insurance sector in India and important activities carried out in a life insurance organization.

The insurers are status conscious, and are proud, as a class, the feeling being nurtured by their staff day in and day out. Brokers have a tough role to deal with them on pricing terms. Any rate quoted by the broker has to be supported by the respective insurers. There is a compelling necessity, in the free market to ensure that all the broking company personnel are knowledgeable in insurance technicalities and are ethical in their conduct and do behave as professional experts in their field, to the satisfaction of the authority and the consumer public.

8.7 KEY WORDS

- **Agents:** In LIC of India, the Agent is a pioneer field force, in procurement of the LIC's business.

- **Investment policy**: The investment policy of the LIC of India should bring a fair return to policy holders consistent with safety.
- **Product development**: To cater consumers' needs about protection against risk factor, provision of future, old age provision, by launching whole life plans, endowment plans, term insurance plans and pensions plans over a period.
- **Rate making:** An insurance rate is the price per unit of insurance.

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8.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

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3. What are the Underwriting
4. What is meant by Rate making
5. Who is insurance agent
6. List out any two objectives of LIC

Big Questions

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1. What are the Functions of Insurers
2. What are the Strategies of Life Insurance Companies
3. What are the Objectives of LIC
4. What are the Role of agents
5. Explain the Activities of LIC
6. List and briefly explain the steps in the underwriting process
7. What sources of information are available to the underwriter?
8. What are the components of the distribution system of life insurance companies

BLOCK-III
PRODUCT DESIGN, INSURANCE UNDER WRITING, CLAIMS

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UNIT 9 PRODUCT DESIGN AND DEVELOPMENT

Structure

9.1 INTRODUCTION

Insurance industry in India has seen a major growth in the last decade along with an introduction of a huge number of advanced products. This has led to a tough competition with a positive and healthy outcome. Insurance sector in India plays a dynamic role in the wellbeing of its economy. It substantially increases the opportunities for savings amongst the individuals, safeguards their future and helps the insurance sector form a massive pool of funds. With the help of these funds, the insurance sector highly contributes to the capital markets, thereby increasing large infrastructure developments in India.

As consumers seek progressively sophisticated and customized insurance products at reasonable costs, Milliman's market-leading expertise is increasingly in demand. With the market undergoing dramatic changes in regulation and receiving outside influence on product design, companies rely on Milliman to stay current on the latest innovations and trends.

Milliman's product development team offers a flexible approach to meet clients' needs. We can serve as a complete, outsourced product-development

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department or provide support to clients' own product design efforts. Our market analysis can assist companies in launching new products or in introducing existing products into new markets.

We offer expertise on both technical and marketing aspects of product development. Our knowledge encompasses distribution strategies, regulatory compliance, underwriting approaches, and product implementation. Our sophisticated modeling of interest rate risks and equity guarantees means we can provide valuable insight into developing competitive and profitable products that meet specific strategic needs.

9.1.1. Strategy in new product design

We can assess the regulatory environment and assist in pricing and product design for a wide range of life and annuity products. We have expertise in the full spectrum of products from pre-need and final expense products to accumulation products, including indexed and variable life insurance products.

Our consultants work with the full range of marketing concepts from direct sales to the advanced sales market for highly affluent customers. We have priced and designed many of the popular secondary guarantee universal life products and have assisted companies in understanding complex reserve calculation.

We develop financial models, assist with due diligence, review the appropriateness of potential products in terms of business objectives, and assist in discussing alternate product designs, compensation strategies, and reinsurance applications. Because we have insurance expertise as well as a large healthcare industry practice, we're able to offer clients unique expertise on both the insurance and healthcare sides of these increasingly popular products.

9.1.2. The Indian Insurance Sector

The Indian Insurance Sector is basically divided into two categories – Life Insurance and Non-life Insurance. The Non-life Insurance sector is also termed as General Insurance. Both the Life Insurance and the Non-life Insurance is governed by the IRDAI (Insurance Regulatory and Development Authority of India). The role of IRDA is to thoroughly monitor the entire insurance sector in India and also act like a custodian of all the insurance consumer rights. This is the reason all the insurers have to abide by the rules and regulations of the IRDAI. The Insurance sector in India consists of total 57 insurance companies. Out of which 24 companies are the life insurance providers and the remaining 33 are non-life insurers. Out which there are seven public sector companies. Life insurance companies offer coverage to the life of the individuals, whereas the non-life insurance companies offer coverage with our day-to-day living like travel, health, our car and bikes, and home insurance. Not only this, but the non-life insurance companies provide coverage for our industrial equipment's as well. Crop insurance for our farmers, gadget insurance for mobiles, pet insurance etc. are some more insurance products being made available by the general insurance companies in India. The life insurance companies

have gained an investment prospectus in the recent times with an idea of providing insurance along with a growth of your savings. But, the general insurance companies remain reluctant to offer pure risk cover to the individuals.

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9.2 PRODUCT DEVELOPMENT IN THE LIFE AND NON-LIFE INSURANCE SECTORS IN INDIA

This unit deals with constantly changing market conditions and regulations, there is a need to develop innovative products that satisfy customer needs. Our consultants have extensive experience with life insurance product development and are well-equipped to provide support at all stages, including carrying out feasibility/field studies, developing product features, carrying out cash-flow modelling and profit testing, developing regulatory filing material, providing support in the UAT/ implementation of the product, and carrying out on-going experience studies.

Over the years, our consultants have been involved in developing different types of products, such as:

- Unit-linked with and without guarantees
- Traditional (participating/non-participating) products
- Pensions and annuities
- Universal life
- Riders
- Group (protection/fund management)

Our consultants can also work with clients to integrate the product with the actuarial modeling software used by the company, such as MG-ALFA, PROPHET and AFM.

9.2.1. Product Development in the Life Insurance in India

Today, companies providing life insurance coverage tend to have high-level services backed with a robust software system. Modern people don't want to spare their time on emailing, calling, or visiting their agents. They need clear and user-friendly systems allowing them to get relevant services online. Thus, along with new policies, products, and pricing, companies modernize or build brand new insurtech platforms. In this object, you can learn more about life insurance product development process and its peculiarities.

According to **AccuQuote,** there are two types of life insurance products: term and permanent. Both types come in different subtypes to satisfy different needs. Permanent type is aimed to provide coverage for as long as you need. There are many kinds of permanent life insurance but the key categories include whole life and universal life. Term life insurance is temporary insurance which may last for 10-30 years, typically. It can provide coverage for the only limited period of time. The policies are quite clear and, usually, cheap. Insurance companies, as

a rule, guarantee that each year you will pay the same cost for your coverage. The rates may vary from $25 to $200 per month. Once your term comes to an end, you will get a notice about the increased costs for life insurance.

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When comparing two types of insurance, we may admit that universal life and whole life cost more than temporary insurance. Unlike term, permanent insurance lasts forever. As long as you pay your premiums, your family members are guaranteed to get the death benefit, no matter when you die. Permanent insurance provides cash value which may be accessed at any time for any reason.

As insurance agencies strive to become more flexible to meet ever-changing market demand and conditions, they constantly look for innovation and ways to improve their products. In terms of better services and products, these companies, usually, choose two ways. Firstly, they can provide better services and products for their customers with the help of new software. Secondly, they can design new types of insurance products. Before proceeding to software solutions, let's talk about the traditional insurance life cycle. Usually, people may plan their life insurance according to definite periods of their lives. Thus, according to **Lenox** Advisors, there are the following stages of life insurance cycle.

Stages of Life Insurance Cycle 25-35 years old clients starting a career and/or marriage during this period of life people need the highest level of insurance which covers basic protection like life value and general family income 35-45 years old clients growing income and/or family on this stage, people usually need insurance for business planning purposes like buying/selling, deferred compensation, business succession, etc. It also comprises tax-advanced strategies, private placement life insurance, and access to an increase in policy cash value, etc. 45-55 years old clients estate/retirement planning includes retirement planning strategies, whole life, supplemental retirement stream, asset, and creditor protection. 55-64 years old clients highest earnings/taxes charitable giving, planned giving, charitable lead trust. 65+ years old clients estate planning estate equalization, liquidity to offset, special needs children planning.

9.2.2. What Software Do Insurance Companies Use? Types, Features, Benefits

If you own an insurance agency or deal with CEOs, you probably know that there are two types of software – prepackaged and custom-designed. The former type is usually built for sale to any company to serve a great number of users. The latter type is typically built specially for one single company that needs a completely customizable solution. Unlike custom software, prepackaged systems cannot be as customized individually as bespoke systems.

The privilege of bespoke software is in its unique set of features and functionalities that face users' needs and requirements. When you create a system from scratch, you can get as many features as you need. And what is more important – you can get only those features your users need. Let's take a closer look at the core features your life insurance software should have.

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9.2.3. Features of life insurance product

- **Life insurance product definition module:** This feature is aimed to provide a definition of new products, edit and modify the existing definition, store and transfer product's data.
- **Policy management:** This feature is designed to manage the group or individual policies. It provides capabilities to register applications, assess risks, present information, modify insurance conditions, handle claims, etc.
- **Fund management:** This feature ensures automatic reports/orders generation. It also offers the following options: accounts management, operations, and orders handling, fund registries, etc.
- **Accounting and finance:** This feature is designed to categorize different events (taxable/non-taxable). It offers reminders of premium underpayment or nonpayment, cash flow management, and other important options. To understand what other features you can get with custom development, let's take a look at Insubiz company. Our company developed a fully customizable solution which offers a lot of options for its users:
    - o CRM
    - o Assets
    - o Claims
    - o Risks
    - o Insurance
    - o Reports
    - o Analysis

The solution is extra user-friendly as it provides all the initial wants and needs of all the stakeholders. Insubiz is easily implemented, provides fast support and regular updates. As you can see, bespoke platforms are able to ensure more functionalities and more options for their users as compared with the prepackaged ones. Speaking about the benefits of implementing a comprehensive software system for managing life insurance policies, we should distinguish the following: With a well-built system in place, you can enhance customer service and support, manage Big Data, and create large client databases. Custom-designed software is also able to automate data processing, sharing, and analyzing. Automation allows eliminating human errors and making insurance processes more efficient and streamlined. All the information is kept in one system and easily accessible.

9.2.4. Life Insurance Product Development Process

If you made up your mind to develop a custom system for managing your life insurance products, you should know how to build it from scratch. In our development best practices, we follow seven basic steps. Here is more information about software development phases.

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- **Step 1 –** Brainstorming During the first stage of SDLC, a team must gather all the initial requirements and come up with innovative ideas. This analysis is performed by senior team members having extensive experience in creating similar products in a given industry. Once all the details are collected, the team can proceed to planning and feasibility analysis.
- **Step 2 –** Feasibility analysis During the second stage of SDLC, all the stakeholders should undertake a feasibility analysis. In-depth research can demonstrate how profitable a project could be. It also incorporates all the factors affecting development. These factors include technical and economic risks. As a result of the feasibility analysis, all the team members should present their estimations regarding time, costs, and resources needed to accomplish the project.
- **Step 3 –** Design Basing on initial requirements, the team writes a detailed SRS documentation (software requirements and specifications). It serves a basis for the product architecture and is usually tightly connected with design document specification (DDS). It is based on various parameters as risk assessment, product robustness, design modularity, budget and time constraints, the best design approach is selected for the product. A design approach clearly defines all the architectural modules of the product along with its communication and data flow representation with the external and third-party modules.
- **Step 4 –** Programming During this stage of SDLC, developers write code according to DDS. The team follows the coding guidelines defined beforehand. The tools and programming languages, which actually make up the technology stack, are also selected in advance.
- **Step 5 –** Integration The objective of this phase is to perform system integration testing and get ensured that the developed systems meet all the requirements with the components and subsystems integrated. The system test may require any number of additional tests depending on the scope and complexity of the requirements; examples include security, conformance, accessibility, performance, stress, compatibility, and regression tests.
- **Step 6 –** Quality assurance and testing This stage is usually a subset of all the stages of SDLC. However, it refers to the testing only stage of the product where product defects are reported, tracked, fixed and retested, until the product reaches the quality standards defined in the SRS.
- **Step 7 –** Release In the software development life cycle, a release is a final stage. It's all about launching a new product for a target audience on a specific market. Sometimes, it can be a beta version of the product or an MVP. With the help of key features going live, developers can evaluate performance and get some valuable feedback from the first users of the product.

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9.2.5. Product Development in the Non-Life Insurance in India

The insurance industry in India has existed for nearly a decade now but only recently it underwent the phase of liberalization and deregulation. Despite over 100s of insurance companies operating across health, life and general sectors, not many citizens realized the importance of non-life insurances until recently. Investing in safety packages for auto, health & travel was treated as expenditure rather than a way out to navigate through various risk scenarios.

Over time, the increased disposable income and improved general awareness have played a crucial role in amplified general & health insurance subscriptions. Having been nationalized in 1972, the industry has come a long way. Consumers have started to realize the value of non-life insurance products. With the upsurge of the start-up ecosystem in India, a significant boost of technology integration into insurance services has been noted, leading to increased adoption of such products.

Entrepreneur India talked to some leading names in the health & general insurance space to assess the market scenario.

Technology – The Game Changer

The penetration of the internet across the Indian borders has brought along endless opportunities for business aspirants. The insurance sector is reshaping with the entrance of new players in the market, by merging product thinking, data and technology with the existing bone structure of the industry.

A Hotbed for Startups

Private players have gained momentum in the insurance space with their flexible approach towards providing such services as they are more open to tailoring their products to the specific needs of the customer. Currently, there are around 30 Private General Insurers operating in India offering a variety of products.

Corporate- Government Connect

Post the economic liberalisation, tonnes of opportunities were available for private players to explore and the government was there to handhold. With reference to health insurance policies, the Insurance Regulatory and Development Authority (IRDA) of India has lineated certain regulations to further support the insurers. “Portability options opened by IRDA in health insurance category is now providing a valuable boost to this category,”

Move from Traditional to Innovative

The insurance industry has embarked on a radical transformation spurred by a series of digital innovations. We are experiencing spur in small ticket products in all segments of general insurance. Startups are coming up with innovative and affordable solutions to fit the bill for millennial by offering non-conventional services like insurance for fitness, daily commute etc.

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Traditionally, these kinds of OTC products were treated as luxury and not many would invest in the services but with time and increased awareness, customers are more willing to spend on something of relevance. Explaining the inclusion of motor insurance cover as a necessary service, Shrikhande said, "Customers do their research online and also want to engage in communication before buying (these) products."

9.3 ROLE OF RISK EVALUATION IN THE PROCESS OF INSURANCE PRODUCT FORMATION

Risk is defines as an event having adverse impact on profitability and/or reputation due to several distinct source of uncertainty. It is necessary that the managerial process captures both the uncertainty and potential adverse impact on profitability and/or reputation. Risk is a part of any business's lexicon, and understanding and subsequently managing it is the most important concern. In banking as well, risk is inherent in the business. Given the impor-tance of risk management, it is no wonder that it is today receiving scrutiny from the world's top banking regulators.

The concept of risk management originates from the business of insurance. It has assumed significance over the years as an important function of management. It basically consists of five processes that aim to mitigate business losses. No organization can completely eliminate risks but it is certainly possible to prepare for them.

Characteristics of Risk Management

- Risk management is a systematic process that deals with the problem of uncertainty. It is an important discipline under the broad subject of management.
- Secondly, one can also refer to it for responding to undesirable events. In this regard, it helps in preparing for worst-case scenarios.
- Lastly, it is also a system that helps in making choices. It provides various alternatives and approaches to help managers select one that has minimum chances of losses.

Risk management plans are never finished. They must be revised periodically because risk, risk control, and risk transfer methods change constantly. Insurance is one of many tools available to risk managers and only one part of the process.

Risk management involves five basic steps:

- Risk/ hazard identification
- Risk/ hazard assessment
- Making decisions about how to control or manage risk

- Implementing those controls
- Supervising the implementation of the plan and watching for any new or changing risks

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Risk / Hazard Identification

Someone said each journey begins with a first step. In risk management the first step is identifying the risks or hazards that might damage property or result in injury to people. Some risks may be obvious. For example, commercial cooking facilities in your dining hall increase the risk of loss or damage to this building, and possibly others near it, from fire. Other risks may be subtler and not so clear, such as the risk of loss of privacy and your camp's responsibility to protect the personal, confidential information of your customers and employees.

There may be risk in the communication process. For example, specialty counselors who are experts in their activities may have a different risk tolerance than the camp directors. Consider the possibility that a trip leader with extensive canoeing experience might place campers at greater risk in certain circumstances than the director finds acceptable because of a different risk baseline. Directors should resist micromanaging, but must be clear about how much risk they're willing to tolerate and that, when in doubt, counselors are to err on the side of safety.

ACA standards offer valuable insight into the risk identification process. They're more than just a good start. Remember, though, each site, facility, and program presents unique risks, and your camp's risk identification process may reveal risks in addition to those addressed specifically by the standards. Challenge your camp management team with the risk identification process if you haven't already done so, and set a reminder to update your risk chart at least annually, not just when you're due for an accreditation visit.

Risk / Hazard Assessment

If the first step is a bit tentative, the second step, risk assessment, is a bold step on the trail to a risk management plan. After identifying risks and hazards unique to your camp, you need to evaluate them based on how frequently they may occur and how severe the potential injury or damage might be. For example, skinned knees and scraped hands may happen often and, as a result, would occupy a high position on the frequency scale. The injury is usually minor though, the kind that can be treated by the camp nurse. Dining hall fires, on the other hand, may happen infrequently, but the result could be catastrophic to your camp and rank high on the severity scale. This risk assessment is the same process insurance company underwriters engage in when they're considering your camp's application for insurance. If you're looking for some insight into risk identification and risk assessment, just look at a camp insurer's application for insurance. Their concerns are revealed by the number of questions they include about various risk issues.

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Risk / Hazard Control

The third step in the risk management process is risk control. Insurance is one risk-control tool, but there are many others. One obvious risk-control option is to avoid the risk entirely. Citing avoidance as a risk-control tool might cause some readers to misunderstand. Risk avoidance doesn't equal no risk and no fun. It is just one side of the equation calculated millions of times each summer. The other side of this risk equation is controlled risk environments.

Insurance policies change regularly as risks evolve. During my tenure in the insurance business, evolving risk has caused insurance companies to develop entirely new policies to respond to employment practice liability risks (wrongful termination, unlawful discrimination, and sexual harassment), environmental impairment liability (pollution), and cyber liability (breach of duty to protect private, confidential information), among others. As in all things, there is a life cycle. After you make decisions about controlling risk and implement those plans, make sure you monitor them to see what is working and what is not. Then the risk management process begins all over again. A few things to keep in mind about risk management:

- Stick to the fundamentals.
- Be disciplined about the process.
- Don't risk a lot for a little.
- Don't cut corners.
- Work with the best advisors you can find.

I've been a regular contributor to Camping Magazine's Risk Management column since 1989. It has been a pleasure and a privilege to be associated with the magazine. This is my last regular column. I'd like to thank all the readers for their interest and attention during the past 28 years. I'd also like to thank all the professional and volunteer staff at the magazine over the years for their patience and assistance. See you along the trail.

9.4 FUTURE TRENDS IN THE DOMAIN OF INSURANCE PRODUCT DESIGN AND DEVELOPMENT

At a time when exceptional client experience is pervasive throughout most other industries, customer-centricity, speed, and flexibility are becoming necessities in insurance product development. As companies such as Amazon and Netflix raise the bar in terms of customer expectations for products and services that are convenient, fast, and personalized, the insurer of the future will likely need to follow suit. And, for all intents and purposes, that future is now.

The good news is that the insurance industry in general, and those targeting the small commercial segment in particular, seem to be coming to terms with this

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new reality. Many insurers are reconsidering outdated product-driven business models to meet customer experience–driven market expectations.

Easier said than done, though. Time to market and agility remain slow and unwieldy for insurance product development, due to cumbersome regulatory oversight, legacy infrastructure, business unit and functional silos, and long-entrenched processes and culture. The challenge could only increase as the rate of digitization accelerates, consumer expectations keep rising, and traditional borders between lines of business continue to blur.

Interviews with small commercial insurance and InsurTech product development leaders in the United States and Canada revealed a keen awareness of these challenges. However, actual transformation remains slow, even though the focus on modernizing product and service development appears to be high. With new risks emerging, and traditional coverage requiring updates to stay relevant in the evolving landscape, the need for more rapid product development transformation seems to be intensifying.

Insurers will likely be tasked with eliminating or minimizing friction throughout their business models, processes, and infrastructure. This could require revisions to the industry's traditional ways of doing business, such as the potentially onerous and difficult-to-understand application process small business owners may face when trying to obtain a policy. Instead, insurers should evolve toward creating a more seamless, customer-driven experience that incorporates tailored options and services, which is already table stakes for most other industries. This article looks at a number of tactics insurers may consider to reach these goals, including several already being implemented by pioneering organizations today.

Check Your Progress

1. What is meant by product development?
2. Define risk management
3. Mention the various steps of risk management
4. What do you understand by risk identification?

9.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. Product development team offers a flexible approach to meet clients' needs. We can serve as a complete, outsourced product-development department or provide support to clients' own product design efforts.
2. Risk management plans are never finished. They must be revised periodically because risk, risk control, and risk transfer methods change constantly.
3. Risk management involves five basic steps:

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- Risk/ hazard identification
- Risk/ hazard assessment
- Making decisions about how to control or manage risk
- Implementing those controls
- Supervising the implementation of the plan and watching for any new or changing risks

4. Someone said each journey begins with a first step. In risk management the first step is identifying the risks or hazards that might damage property or result in injury to people. Some risks may be obvious.

9.6 SUMMARY

In this unit, you have learnt about the product and development in the life and non-life insurance sectors, role of risk evaluation in the process of insurance product formation and future trends in the domain of insurance product design and development.

The insurance industry of India consists of 57 insurance companies of which 24 are in life insurance business and 33 are non-life insurers. Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. Apart from that, among the non-life insurers there are six public sector insurers. In addition to these, there is sole national re-insurer, namely, General Insurance Corporation of India (GIC). Other stakeholders in Indian Insurance market include agents (individual and corporate), brokers, surveyors and third party administrators servicing health insurance claims. The future looks promising for the life insurance industry with several changes in regulatory framework which will lead to further change in the way the industry conducts its business and engages with its customers. The overall insurance industry is expected to reach US$ 280 billion by 2020. Life insurance industry in the country is expected grow by 12-15 per cent annually for the next three to five years. Demographic factors such as growing middle class, young insurable population and growing awareness of the need for protection and retirement planning will support the growth of Indian life insurance.

9.7 KEY WORDS

- **Product Development:** A flexible approach to meet clients' needs.
- **Non-life Insurance:** The Non-life Insurance sector is also termed as General Insurance.
- **Policy management:** To manage the group or individual policies. It provides capabilities to register applications, assess risks, present information, modify insurance conditions, handle claims, etc.

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- **Fund management:** It ensures automatic reports/orders generation. It also offers the following options: accounts management, operations, and orders handling, fund registries, etc.
- **Accounting and finance:** This feature is designed to categorize different events (taxable/non-taxable).
- **Risk management**: Risk management plans are never finished. They must be revised periodically because risk, risk control, and risk transfer methods change constantly.

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9.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. What is meant by product development
2. Define risk management
3. Mention the various steps of risk management
4. What do you understand by risk identification
5. What are the essential of risk management
6. Define the term 'Risk'

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Big Questions

1. Explain the concept of risk
2. Discuss the characteristics of risk
3. Explain the various types of risk
4. Explain the process of risk management
5. What are the role of risk evaluation in the process of insurance product formation
6. What Software Do Insurance Companies Use?
7. Explain the product development in the life insurance sector in India

UNIT 10 INSURANCE UNDERWRITING

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Structure

10.1 INTRODUCTION

Insurance underwriters are professionals who evaluate and analyze the risks involved in insuring people and assets. Insurance underwriters establish pricing for accepted insurable risks. The term underwriting means receiving remuneration for the willingness to pay a potential risk.

Underwriting is selecting and classifying risk exposures. To earn a profit in insurance, a proper rate must be set to cover the losses of the insured, to cover the related expenses, and to earn a reasonable profit. To find the proper rate, or premium, actuarial studies are used to determine what characteristics of the insured can be used to forecast future losses. The proper rate, then, depends on those characteristics. The 2nd requirement to earn a profit in insurance is to make sure that those rates are applied only to those insurance applicants that have those characteristics. Underwriting is accurately classifying insurance applicants according to those rating variables; otherwise, the rates based on actuarial studies may not cover the exposure that the insurance company is undertaking if they misclassified the applicants or selected the wrong applicants. In essence, underwriting strives to charge the right rates to the right applicants. Stated another way, the primary goal of underwriting is to minimize the difference between actual losses and expected losses for each insured.

Successful underwriting requires that there be an adequate volume of exposures for each rating class, with a minimum concentration of exposures. It also requires good judgment and thorough knowledge of the underwriting criteria and knowing how to avoid mistakes in selections that often occur with each type of coverage.

Every insurance company has an underwriting guide that specifies the underwriting policy: what lines of insurance will be covered; prohibited exposures;

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amount of coverage allowed for each exposure; permitted geographic areas for each line of insurance; and any other restrictions deemed pertinent to the underwriting process; forms rating plans to be used; acceptable, borderline, and prohibited business; amounts of insurance to be written; insurance applications that require approval by a senior underwriter.

Underwriting policies conform to company objectives, which may be to sell large-volume at low profit or vice versa.

The underwriting policy may also have specific procedures for rating applicants. For instance, most life insurers use a numerical rating system, assigning a point for each type of physical disability or other variable that increases expected mortality above standard risks, with the premium surcharge applied commensurate with the increased risk. Surcharges may only apply for the 1st few years or for the entire term of the policy. In the 1st few years, the life insurance benefit may be limited to the premiums paid.

Because much of the underwriting is done by agents in the field, they are sometimes referred to as field underwriters. A desk underwriter, also known as a line underwriter, ensures that the insurance applicants have been properly classified by the insurance sales agents. Although the term underwriter is often applied to life insurance agents, underwriting is generally more important for property and liability insurance, because there is much greater variation in the ratemaking variables, and thus, in the underwriting criteria. Indeed, property and liability insurance agents are often paid a contingency contract or profit-sharing contract, which pays them an additional commission if the insurance business they underwrite is profitable.

In many cases, such as for property and liability insurance, the insurance agent often has the authority to bind the insurance company when the policy is sold. However, the company underwriter can cancel the policy afterwards, within certain time limits, if the application does not conform to underwriting guidelines.

Nowadays, underwriting decisions are computerized for those lines of insurance that are standardized, such as auto and homeowner’s insurance. Nonetheless, the information provided to the computers must still be accurate.

10.2. NEED FOR INSURANCE UNDERWRITING

Insurance underwriters evaluate the risk and exposures of potential clients. They decide how much coverage the client should receive, how much they should pay for it, or whether even to accept the risk and insure them

Insurance companies assume billions of dollars in financial risk annually, risk that is transferred to them from individuals and businesses via the insurance transaction. Insurance underwriters, using the underwriting process and various supporting underwriting tools, are employed by insurers to assess both their new and current business. An insurance company’s overall profitability can depend significantly on the quality of its underwriting.

Underwriting has multiple purposes. The overarching purpose is to develop and maintain a profitable book of business for the insurer. Underwriting is crucial to an insurer's success; underwriting goals flow directly from the insurer's corporate strategies and objectives. Favorable underwriting results are necessary for an insurer's ability to sustain profitable growth.

To achieve profitability, the underwriting function serves additional purposes:

- Guarding against adverse selection
- Ensuring adequate policyholders' surplus
- Enforcing underwriting guidelines

Guarding against Adverse selection

Underwriters are an insurer's guard against adverse selection. These are examples of adverse selection:

- Some property owners in areas prone to coastal storms purchase wind-storm coverage or increase their limits only before a hurricane season, when they expect severe losses.
- A disproportionate percentage of property owners in an earthquake-prone zone purchase earthquake insurance, as compared to property owners in areas less prone to earthquakes.

Underwriters minimize the effects of adverse selection by carefully selecting the applicants whose loss exposures they are willing to insure, charging appropriate premiums for the applicants that they do accept with premiums that accurately reflect the loss exposures, and monitoring applications and books of business for unusual patterns of policy growth or loss.

Ensuring Adequate Policyholders' surplus

An insurance company must have adequate policyholders' surplus if it wishes to increase its written premium volume. An insurer's capacity is limited by regulatory guidelines and often by its own voluntary constraints, which are frequently more conservative than those imposed by regulators. If an insurer's underwriting practices generate policy premiums that exceed losses and expenses, the policyholders' surplus will increase, thereby increasing capacity.

Underwriters ensure the adequacy of policyholders' surplus by adhering to underwriting guidelines, making certain that all loss exposures are correctly identified, and charging adequate premiums for the applications that are accepted.

Enforcing underwriting guidelines

Underwriting guidelines reflect the levels of underwriting authority that are granted to varying levels of underwriters, producers, and managing general agents (MGAs). Exactly who has what level of underwriting authority varies considerably by insurer and by type of insurance.

Underwriting ensures that applicants accepted adhere to underwriting guidelines. If loss exposures, risks, or policy limits on an application exceed an underwriter's authority, he or she will seek approval through supervisory and management ranks within the underwriting department.

10.3. FACTORS THAT AFFECT THE ACTIVITIES PERFORMED BY THE UNDERWRITER

In the insurance industry, the practice of underwriting refers to the process of accepting or rejecting risks. It is the very heart of insurance and is the first step taken by an insurance company to generate premiums. Originally, insurance and underwriting were synonymous. That is, underwriting referred to the operation of the insurance business. As the insurance industry developed, underwriting took on a more specialized meaning.

In the early days insurance was more personal than it is today. A contract was drawn up between a property owner and a second party, who was willing to insure the specified property, or between the insured and the insurer. The contract specified the terms under which the property would be insured. The property owner placed his name at the top of the contract, stating that he was the owner of the property and beneficiary of the contract if the property was subsequently damaged. The other party, who guaranteed the contract and was the insurer, signed his name below, at the bottom of the contract. Literally, he "underwrote" the contract.

An underwriter is the person who decides whether or not to insure risks for which applications have been submitted. The underwriter's task is to evaluate a risk, estimate the potential exposure, determine the likelihood of loss, then make a decision whether or not to accept the application for insurance.

The term "underwriter" developed in the early days of marine insurance. It was common practice for individuals seeking insurance for a ship and its cargo to meet with those desiring to write such insurance in coffeehouses. A person seeking insurance for his ship and its cargo would bring a paper describing the ship, its contents, crew, and destination to the coffeehouse. The paper would circulate, with each individual who wished to assume some of the obligation signing his name at the bottom and indicating how much exposure he was willing to assume. An agreed-upon rate and terms were also included in the paper. Since these people signed their named under the description of the risk, they became known as underwriters.

As insurers changed from individual to companies, signatures on insurance contracts became those of company officers. The term underwriter continued to be used in a more restrictive sense; it applied only to the person who performed the process of selecting risks and determining the terms of insurance. Risk selection and determination of policy terms continue to be the basic duties of underwriters today.

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Underwriters work for insurance companies. In addition to on-the-job training, they may earn an Associate in Underwriting designation from the Insurance Institute of America. In the life insurance segment, underwriters may enter a program of study that leads to the designation of Chartered Life Underwriter (CLU). Most CLU's are engaged in some aspect of insurance sales as well. In the property and casualty insurance segment, underwriters may work toward the designation of Chartered Property Casualty Underwriter (CPCU).

The process of underwriting involves four factors: 1) selection of risks, 2) classification and rating, 3) policy forms, and 4) retention and reinsurance. By performing these four functions the underwriter increases the possibility of securing a safe and profitable distribution of risks.

Risk Selection

In this step the underwriter decides whether or not to accept a particular risk. It involves securing factual information from the applicant, evaluating that information, and deciding on a course of action. The underwriter is typically aided by a list of acceptable and prohibited risks.

Classification and Rating

Once the risk has been accepted, the underwriter then classifies and rates the policy. Several tentative classifications are usually assigned before a final decision on classifying the risk is reached. The purpose of using classifications is to separate risks into homogeneous groups to which rates can be assigned. Insurers may have their own classification and rating system, or they may obtain a system from a rating bureau.

Policy Forms

After determining the acceptability of an applicant and assigning the proper classification and rating, the underwriter is ready to issue an insurance policy. The underwriter must be familiar with the different types of policies available as well as be able to modify the form to fit the needs of the applicant. The first three underwriting functions risk selection, classification and rating, and policy selection— are interdependent. That is, the underwriter determines that a certain risk is acceptable when specified rates and forms are used. The underwriter also performs a fourth separate function on every risk before the underwriting is complete: reinsurance.

Retention and Reinsurance

Reinsurance involves protecting the insurance company against a certain portion of potential losses. Every risk presents the possibility of loss that will equal or exceed the policy limits. It is up to the underwriter to protect his or her company from undue financial strain. The underwriter does this by retaining only a certain portion of the risk and securing reinsurance for the remainder of the risk.

There are numerous factors considered when underwriting a life insurance policy.

First, an underwriter will need to determine the probability of an applicant's life lasting as long, or even longer, than the "average" life expectancy for an individual of that particular age and gender.

In this estimate of life expectancy, if the applicant were to live as long or longer than anticipated based on the mortality table, then the funds that the insured has paid into the policy in the form of premiums will typically create enough of an investment for the insurer to take on the risk.

This means that even after the insured has passed away, the total amount of premium that he or she paid into the policy over time – combined with such funds' invested return will be more than what the insurer will pay out in the form of a death benefit on the policy, resulting in a profit to the insurance company.

Given this, life insurance underwriters will also analyze factors that could possibly cause an applicant to pass away prior to their average life expectancy. Such factors could include a family history of certain health impairments such as cancer or stroke, as well as external factors such as working in a dangerous occupation.

10.4. STEPS INVOLVED IN THE PROCESS OF INSURANCE UNDERWRITING

Filling up the long pages of forms, answering numerous questions from the insurer's questionnaire and umpteen signatures is no doubt the most dreaded part when buying an insurance policy. However, this underwriting process is an essential part of the insurance application process and would unlikely go away. The good news is that there are policies which are based on simplified underwriting or even guaranteed acceptance where the process is less tedious although it is not without cons.

Underwriting Guidelines

- Proposed Insured's ages are from 1 month 1 day to 70 years of age's 70 years of age is only acceptable for certain insurance plans.
- One life insurance plan can be selected at a time with or without riders, e.g. waiver of premium rider, accidental rider, hospital and surgical rider, hospital benefit rider, dread disease rider, term life rider, payer benefit rider, etc.
- The underwriting acceptance is based on various risk factors, e.g. health status, occupation, life style, financial risk factor, etc.

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Underwriting Documents Required

If the proposed Insured is aged between 1 month 1 day and 15 years:

- Insurance application for juvenile (aged below 16 years)
- Copy of birth certificate or copy of valid ID Card
- Copy of health check-up documentation at the insured age of 1 year old.
- Authorization of the juvenile's parent to disclose the proposed Insured's medical treatment history
- Agent's report
- Temporary binding receipt

If the proposed Insured is aged 16 years and above:

- Insurance application (aged 16 years & above)
- Copy of valid ID card
- Authorization of the Insured
- Agent's report
- Temporary binding receipt

Underwriting Process

Once the company receives the completed documents outlined under item 2, the company will underwrite as follows:

- Issue a standard premium rate policy to an Insured without further request for documentation.
- The company may request additional information to support the underwriting decision, e.g. a request for an additional physical examination, a request for past medical history, and the completion of an additional questionnaire.
- The company will notify the proposed Insured of any additional requirements. The company may underwrite the case with a higher premium rate policy based upon the present health status, past history of health, occupation. The company will issue a counter-offer to the proposed Insured.
- Once the proposed Insured accepts the counter-offer with an extra premium paid (if any) or with a premium refund (if any), the company will issue a policy for the proposed Insured. Once the company underwrites and accepts the case, whether at its standard rate or sub-standard rate, it will issue a policy with a 'free look' form to the Insured. The Insured needs to review the policy for correctness, sign the 'free look' form, and return it to the company.
- Should the company not receive the additional documents/requirements within a specified period, the company will terminate the application and return all premiums (if any) to the proposed Insured.

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- If the proposed Insured declines the company's counter-offer, the company will terminate the application and refund all premiums (if any) to the proposed Insured.
- If the company postpones or declines the application, the company will notify the proposed Insured by letter and refund all premiums (if any) to the proposed Insured.

Underwriting Time Frames

- The company will issue a policy within 15 days from the date of document completion for a standard rate case.
- If any additional documents or information is required, the company will notify the proposed Insured by letter within 30 days from the date of the application's submission.
- Once the Insured receives a policy with the 'free look' form and finds that it is correct, the Insured has to sign the 'free look' form and return it to the company within 15 days from the date of receiving the policy.

Check Your Progress

1. What is meant by underwriting?
2. Give the meaning of Reinsurance.
3. What is Risk Selection?
4. What are the Classification of Rating?

10.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. Insurance underwriters are professionals who evaluate and analyze the risks involved in insuring people and assets. Insurance underwriters establish pricing for accepted insurable risks.
2. Reinsurance involves protecting the insurance company against a certain portion of potential losses. Every risk presents the possibility of loss that will equal or exceed the policy limits. It is up to the underwriter to protect his or her company from undue financial strain.
3. In this step the underwriter decides whether or not to accept a particular risk. It involves securing factual information from the applicant, evaluating that information, and deciding on a course of action.
4. Once the risk has been accepted, the underwriter then classifies and rates the policy. Several tentative classifications are usually assigned before a final decision on classifying the risk is reached.

10.6. SUMMARY

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In this unit, you have learnt about the insurance underwriting, need for insurance underwriting, factors that affect the activities performed by the underwriter and step involved in the process of insurance underwriting.

Many people may not be familiar with the underwriting process, but knowing the factors that affect the decision of the insurers of placing you into one of the risk groups, is very useful. In this way, you can easily know if you can be chosen as a potential customer based on your personal information and even if you are not chosen as a potential customer, you might at least know what to avoid in order to decrease the chance of your policy being rejected. Finally, we have to notice the importance of the credit scores, because many insurance companies used it nowadays to price the premiums. Having a good credit history is a key factor to get a lower premium rate in the policy.Therefore underwriting is critically important function and is performed each time an insurance application is taken. Its purpose is to determine whether or not the insurer will issue a policy to an applicant

10.7 KEY WORDS

- **Underwriting:** Receiving remuneration for the willingness to pay a potential risk.
- **Policy form:** After determining the acceptability of an applicant and assigning the proper classification and rating, the underwriter is ready to issue an insurance policy.
- **Reinsurance:** Reinsurance involves protecting the insurance company against a certain portion of potential losses.
- **Risk selection:** The underwriter decides whether or not to accept a particular risk.
- **Rating:** The underwriter then classifies and rates the policy.

10.8 FURTHER READINGS

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10.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. What is meant by underwriting ?
2. Give the meaning of Reinsurance.
3. What is Risk Selection?
4. What are the Classification of Rating?

Big Questions

1. What are need for insurance underwriting?
2. What are factors that affect by underwriters?
3. What are steps involved in the process of insurance underwriting?

UNIT 11 CLAIMS MANAGEMENT

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Structure

11.1 INTRODUCTION

Claims management services consist of advice or services in respect of claims for compensation, restitution, repayment or any other remedy for loss or damage, or in respect of some other obligation. Claims management services cover litigation, or claims under regulation schemes or voluntary arrangements.

In addition to the competitive environment in which insurance companies operate, these businesses are challenged by more stringent compliance with government regulations and increasing expectations on the part of consumers. Efficient claims management is vital to the success of both large and small companies working within the insurance industry. Major components of the claims handling process include developing strategies to cut costs and reduce fraud while keeping customers satisfied. Small companies in particular can benefit from claims management tools and technology.

Settling Claims

Settling insurance claims is just one aspect of the claims management process. The time it takes to process a claim involves several stages beginning with a person filing a claim. The stages that follow determine if a claim has merit as well as how much the insurance company will pay. Insurance customers expect a company to settle claims quickly and to their satisfaction. Because high customer satisfaction levels can give a company a competitive edge, reducing the time it takes to settle insurance claims is one way to decrease the number of customer complaints and improve service. The use of claims management system software that speeds the process and minimizes costs offers a practical solution. Simplifying the claims process through automation helps reduce expenses for smaller companies that operate with smaller budgets.

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Detecting Fraud

Paying fraudulent claims costs insurance companies money a cost the insurance industry then passes on to its customers. Consequently, underwriting guidelines become tougher and the insurance premiums consumers pay increase. Software tools designed to examine payment history and evaluate trends in claim payoffs can help insurance companies detect fraud, according to Wipro, a global IT business. For example, how often the same individual files an insurance claim can be a warning that a person might be filing a fraudulent claim. Unfortunately, settling claims too quickly increases a company's chance of paying out on a greater number of fraudulent claims. Unlike large companies that can absorb some losses as a part of doing business, small companies quickly suffer the negative effect on net earnings when paying fraudulent claims. Then again, processing insurance claims too slowly increases the risk of losing dissatisfied customers. In a highly competitive insurance market, small companies can't afford to lose customers.

Lowering Costs

Monitoring costs throughout the claims management process determines how much of a customer's premium rate goes toward paying for the insurance company's administrative costs. Generally speaking, when settling a claim is delayed, it costs the insurance company more money. The higher claim costs reduce profitability. For small and large insurance companies alike, automation of some of the claims management process can help decrease a company's operating costs. One example is the increased cost of investigating a claim manually. Information technology systems, though, improve efficiency by decreasing the number of claim errors, detecting fraud early and reducing the time it takes to process and settle a claim all factors that cut an insurance company's costs and increase profitability. Even in a healthy economy, running a small business can be tough. Other essential functions of the claims management process that can reduce costs include developing programs directed at preventing claims before they occur and avoiding future claims.

Avoiding Litigation

In most cases involving insurance claim disputes, the insurance company eventually agrees to pay an equitable amount if a customer has a legitimate claim and can present evidence supporting it. Although quickly settling a claim can avoid the chances for litigation, accurate liability assessment is crucial to achieving a quick resolution in a claim dispute. Insurers work to evade litigation because it substantially increases the company's cost of settling a claim. For instance, one-time cases where a person misrepresents information he provides on an insurance application can be expensive for an insurance company to prove legally. Causing a company financial loss is another reason to avoid litigation. Small insurance companies are not immune but rather are increasingly exposed to potential litigation involving claim disputes.

11.2. FACTORS AFFECTING THE INSURANCE CLAIM MANAGEMENT SYSTEM

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Insurance Claims Management Software focus primarily on providing information essential for the evaluation of claims with a centralized system of record. Beyond providing operational efficiency in the management of claims, insurance claims systems should also reduce the risk of fraudulent claims by providing access to all relevant data associated to claims in an organized fashion, supporting risk evaluation.

Insurance claims management software helps insurers manage and evaluate insurance claims. They allow agents to manage the claims process with automated workflows, ensuring that all claim details are recorded within a centralized system. Claim details can include litigation, negotiation, settlement communications, relevant policy information, and claim assessments. Insurance claims management systems are commonly used by both independent and enterprise insurance agencies to support agents as they manage their clients' claims. Insurance claims management products can help insurers reduce claims management costs, reduce fraudulent claims, and enhance customer experience. Insurance claims management products can be implemented either as a standalone solution or as part of an integrated insurance suite.

To qualify for inclusion in the Insurance Claims Management software category, a product must:

- Support claims and settlement workflows
- Provide risk assessment capabilities to identify claim complexity and likelihood of litigation
- Analyze data to detect potential instances of fraudulent claims
- Allow users to create claim reports

11.3. TYPES OF DOCUMENTS NEEDED IN VARIOUS TYPES OF CLAIMS

a) **Insurance Policy:** The insurance policy sets out all the terms and conditions of the contract between the insurer and insured.

b) **Certificate of Insurance:** It is an evidence of insurance but does not set out the terms and conditions of insurance. It is also known as 'Cover Note'.

c) **Insurance Broker's Note:** It indicates insurance has been made pending issuance of policy or certificate. However, it is not considered to be evidence of contract of insurance.

When and Why to Insure

Before shipment of goods, exporter has to insure to goods. Date of coverage in insurance policy should always be earlier o the date of shipment of goods, then

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only insurance covers totally. Banks insist the date of insurance to be earlier to the date of shipment of goods, at the time of negotiation of documents. Any person who has 'insurable interest' in the goods only can insure. Exporter is said to have interest in the safe arrival of goods. Equally, its loss, damage or detention will prejudice exporter. When the cargo is sent on CIF basis, exporter invariably takes marine insurance, as it is his duty to cover the risk. Till ownership in goods is transferred, in his own interest, exporter has to take the coverage. There is no obligation to the exporter to take insurance, after transfer of ownership. Still, it will be wise for the exporter to take adequate insurance policy till the goods reach the end of voyage. Here are the reasons:

- Importers insurance may be inadequate.
- In case of insolvency of the importer, claim amount may go to the benefit of the importers creditors and exporter would not receive the payment.
- Foreign exchange problems could complicate the remittance of insurance claim amount to the exporter.

How to Insure

There are two ways to insure. First, take insurance policy as and when shipment is made. Those exporters, who make shipment now and then, do this. The second and common mode is to take open policy. Under open policy, the exporter does not have to take insurance contract , every time, as and when shipment is made. He pays insurance premium, in advance, one year. The insurance company undertakes to indemnify the insured up to the amount of the policy. Shipment of goods to the extent of the policy amount is covered. A brief declaration by the exporter about the basic facts of shipment would do. A great volume in exports business prefers this method for the following obvious advantages:

a) Exporter enjoys automatic and continuous protection. Even if there is delay in declaration or exporter has overlooked to submit declaration, the shipment is covered provided the delay and oversight are not intentional.
b) Trouble of taking insurance policy, each time, is avoided.
c) Exporter will have prior knowledge of the premium amount and so exporter can quote competitive rate for this exports.
d) Better relationship between the exporter and insurance company will be developed, so better advice would be available. As the insurance company understands the requirements in a better way, the insurance company can develop tailor-made protection to the exporter.

An insurance claim is a formal request to an insurance company asking for a payment based on the terms of the insurance policy. The insurance company reviews the claim for its validity and then pays out to the insured or requesting party (on behalf of the insured) once approved. The non-life insurance industry is witnessing shifting trends across policy administration, and claims the two core functions in insurance. The claims process is the defining moment in a non-life

insurance customer relationship. To retain and grow market share and improve customer acquisition and retention rates, insurers are focused on enhancing customers' claims experience.

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In a highly competitive insurance market, differentiation through new and more effective claims management practices is one of the most important and effective ways to maintain market share and profitability. In particular, insurers can transform the claims processing by leveraging modern claims systems that are integrated with robust business intelligence, document and content management systems. This will enhance claims processing efficiency and effectiveness. It can benefit the insurers both operationally and strategically by enabling them to reduce claims costs to improve their combined ratio, improve claims processing efficiency, and drive customer retention and acquisition.

Today in any insurance office the claim process is built on

- Claim document & content management tool
- Mobile based & smart phone based technology solutions the key
- STP processing to minimize delay
- Modern claim processing platform which is seamless & robust

Normal claim process followed by General Insurers

- An insured or the claimant shall give notice to the insurer of any loss arising under contract of insurance at the earliest or within such extended time as may be allowed by the insurer.
- On receipt of such a communication, a general insurer shall respond immediately and give clear indication to the insured on the procedures that he should follow. In cases where a surveyor has to be appointed for assessing a loss/ claim, it shall be so done within 72 hours of the receipt of intimation.
- Where the insured is unable to furnish all the particulars required by the surveyor or where the surveyor does not receive the full cooperation of the insured, the insurer or the surveyor as the case may be, shall inform in writing the insured about the delay that may result in the assessment of the claim.
- The surveyor shall be subjected to the code of conduct laid down by the Authority while assessing the loss, and shall communicate his findings to the insurer within 30 days of his appointment with a copy of the report being furnished to the insured, if he so desires. Where, in special circumstances of the case, either due to its special and complicated nature, the surveyor shall under intimation to the insured, seek an extension from the insurer for submission of his report.
- In no case shall a surveyor take more than six months from the date of his appointment to furnish On receipt of the survey report or the additional survey report, as the case may be, an insurer shall within a period of 30

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days offer a settlement of the claim to the insured. If the insurer, for any reasons to be recorded in writing and communicated to the insured, decides to reject a claim under the policy, it shall do so within a period of 30 days from the receipt of the survey report or the additional survey report, as the case may be.

- Upon acceptance of an offer of settlement by the insured, the payment of the amount due shall be made within 7 days from the date of acceptance of the offer by the insured. In the cases of delay in the payment, the insurer shall be liable to pay interest at a rate which is 2% above the bank rate prevalent at the beginning of the financial year in which the claim is reviewed by it.

How to Make a Claim under Motor insurance

A claim under a motor insurance policy could be

- For personal injury or property damage related to someone else. This person is called a third party in this context) or
- For damage to insured own vehicle. This is called an own damage claim and insured is eligible for this if he is holding what is known as a package or a comprehensive policy.

Third Party Claim

In a third party claim, where insured vehicle is involved, it is important to ensure that the accident is reported immediately to the police as well as to the insurance company. On the other hand, insured is a victim, that is, if somebody else's vehicle was involved, he must obtain the insurance details of that vehicle and make intimation to the insurer of that vehicle.

Own Damage Claim

In the event of an own damage claim, that is, where insured vehicle is damaged due to an accident, insured must immediately inform insurance company and police, wherever required, to enable them to depute a surveyor to assess the loss.Insured must not attempt to move the vehicle from the accident spot without the permission of police and insurer.

Theft Claim

If P H own vehicle is stolen, he must inform the police and the insurance company immediately. In addition you must keep the transport department also informed. As soon P H receives the policy document, he must read about the procedures and documentation requirements for claims. If P H has to make a claim, he must ensure that he collects all the required documents and submit them along with the requisite claim form duly filled in, to the insurance company. There may be certain specific documentation requirements for specific types of claims. For instance in

respect of a theft claim, there is a special requirement that P H should surrender the vehicle keys to the insurance company.

Property insurance claim

There could be several types of policies that cover property and the property itself could be stationery - like a building, or moving around - like your household goods being transported. P h on receipt of policy document must familiarize himself with the documents required for a claim as well as the procedures to be followed. Whether or not a claim arises P H must follow the various dos and don’ts in respect of his property for the duration of the policy. These dos and don’ts are termed warranties and conditions in the policy document. In general, losses and damages, including those due to theft, fire and flood need be intimated to the relevant authorities such as the police, the fire brigade and so on. It is important to ensure that P H must intimate insurance company to enable it to send a surveyor for surveying and assessing the loss.

Travel insurance claim

Travel insurance policy is generally a package policy that includes different types of covers like hospitalization, personal accident, loss/ damage to baggage, loss of passport and so on. The procedure and documents required for a claim would vary from cover to cover. For ease of procedure and convenience, insurers normally attach the claim form with the policy document. This will contain the list of documents required in case of a claim and also the contact details including phone numbers of the claims administrator either in the destination country to which you are traveling or in another country that is designated to receive and process your claim intimation.

Formalities for a health insurance claim

P H can make a claim under a Health insurance policy in two ways:

- Cashless basis and
- Reimbursement basis

On a Cashless basis: For a claim on cashless basis, treatment must be only at a network hospital of the Third Party Administrator (TPA) who is servicing your policy. P h must seek authorization for availing the treatment on a cashless basis as per procedures laid down and in the prescribed form. He must read the policy document as soon as he receives it, to understand claim process and not read it at the time claim arises.

Claims on reimbursement basis: P H must read the clause relating to claims in policy document as soon as he receives it to ensure that he understands the procedure and the documents required for making a claim on reimbursement basis. When a claim arises he should inform the insurance company as per procedures required. After hospitalization, he has to ensure that he obtains and keep ready

documents such as claim form, discharge summary, prescriptions and bills that he should submit for a claim.

Every insurer in their website clearly provide all relevant information relating to

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- How to lodge a claim
- What documents to be kept in possession
- Whom to be contacted to lodge a claim
- What information needs to be provided in lodging a claim
- Claim process adopted by the insurer
- How to follow up on claims lodged
- Help desk details to support customer service

This information are also included as part of policy document in every sales brochure or communication.

11.4. MEANING OF 'CAUSA PROXIMA' IN INSURANCE CLAIM SETTLEMENT

It is a rule of law that in actions on fire policies, full regard must be had to the causa proxima. If the proximate cause of the loss is fire, the loss is recoverable. If the cause is not fire but some other cause remotely connected with fire, it is not recoverable, unless specifically provided for. Fire risks do not cover damage by explosion, unless the explosion causes actual ignition, which spreads into fire. The cause of the fire is immaterial, unless it was the deliberate act of the insured.

Steps to be taken in fire insurance claims

- It is the duty of the insured, or any other person on his behalf, to give immediate notice of fire to the insurance company so that they can safeguard their interest, such as, deal with the salvage, judge the cause and nature of fire and assess the extent of loss caused by the fire.
- Failure to give notice may avoid the policy altogether.
- The insured is further required by the terms of the policy, to furnish within the specified time, full particulars of the extent of loss or damage, proof of the value of the property and if it is completely destroyed, proof of its existence.
- Delivery of all these details to the company is a condition precedent to the claim of the assured to recover the loss. If the assured prefers a fraudulent claim, whether for whole or part of the policy, he would forfeit all benefits under the policy, whether or not there is a condition to this effect in the policy. Generally, the fraud consists in over -valuation, but over-valuation due to mistake is not fraudulent. In a majority of fire insurance claims, the expert assessors of the company are able to arrive at mutually acceptable valuation.

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Check Your Progress

1. What is meant by claim management?
2. Give the meaning of term 'Causa Proxima'
3. What do you understand by Insurance Claims Management Software?
4. What is Certificate of Insurance?

11.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. Claims management services consist of advice or services in respect of claims for compensation, restitution, repayment or any other remedy for loss or damage, or in respect of some other obligation. Claims management services cover litigation, or claims under regulation schemes or voluntary arrangements.
2. It is a rule of law that in actions on fire policies, full regard must be had to the causa proxima. If the proximate cause of the loss is fire, the loss is recoverable. If the cause is not fire but some other cause remotely connected with fire, it is not recoverable, unless specifically provided for. Fire risks do not cover damage by explosion, unless the explosion causes actual ignition, which spreads into fire.
3. Insurance Claims Management Software focus primarily on providing information essential for the evaluation of claims with a centralized system of record. Beyond providing operational efficiency in the management of claims, insurance claims systems should also reduce the risk of fraudulent claims by providing access to all relevant data associated to claims in an organized fashion, supporting risk evaluation.
4. It is an evidence of insurance but does not set out the terms and conditions of insurance. It is also known as 'Cover Note'.

11.6. SUMMARY

In this unit, you have learnt about the claims management, factors affecting the insurance claim management system, types of documents nneed in various types of claims and 'Causa Proxima' in insurance claim settlement.

The best tools of the trade are communication and influencing skills that can often remove or reduce the impact of these hurdles and facilitate the endgame. While these are generic skills that unarguably enable better business and interactions across all functions, they are especially useful and important to the claim resolution process where so many headwinds serve to upend a process that, when functioning

NOTES

well, can serve all parties' interests in what they want out of the claim.Claim Management System is a web-based system that is used to manage travel claim and overtime work claim. An enforcement staff can make travel claim application and overtime work claim. A supervisor can verify staff's claim and a financial manager can approve staff's claim. Financial clerk is able to view staff salary to proceed on salary payment. Furthermore, supervisor and financial managers are able to generate reports. The system has shorten the process and time for claims application and approval.

In many cases, life insurance claims have been delayed or denied due to lack of proper documentation or simply because the proper claim process was not followed. Hence, it is recommended that the claimant should be aware of the claim process in order to have a hassle-free claim settlement process during the emotionally draining time especially while filing a death claim.

11.7 KEY WORDS

- **Claims management**: Claims management services cover litigation, or claims under regulation schemes or voluntary arrangements.
- **Insurance Claims Management Software**: To focus primarily on providing information essential for the evaluation of claims with a centralized system of record.
- **Data**: Analyze data to detect potential instances of fraudulent claims
- **Insurance Policy:** The insurance policy sets out all the terms and conditions of the contract between the insurer and insured.
- **Certificate of Insurance:** It is an evidence of insurance but does not set out the terms and conditions of insurance. It is also known as 'Cover Note'.
- **Insurance Broker's Note:** It indicates insurance has been made pending issuance of policy or certificate. However, it is not considered to be evidence of contract of insurance.
- **Third party claim:** where insured vehicle is involved, it is important to ensure that the accident is reported immediately to the police as well as to the insurance company.
- **Travel insurance policy:** A package policy that includes different types of covers like hospitalization, personal accident, loss/ damage to baggage, loss of passport and so on.
- **Causa Proxima** : It is a rule of law that in actions on fire policies, full regard must be had to the causa proxima.

11.8 FURTHER READINGS

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11.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. What is meant by claim management?
2. Give the meaning of term ‘Causa Proxima’.
3. What do you understand by Insurance Claims Management Software?
4. What is Certificate of Insurance?

Big Questions

1. What are the factors affecting the insurance claim management system?
2. Explain the types of documents needed in various of claims.
3. Discuss the claim management.
4. How to Make a Claim under Motor insurance?
5. What are the formalities followed by the health insurance claim?
6. Explain the Steps to be taken in fire insurance claims.

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BLOCK -IV
INSURANCE PRICING & MARKETING, RE-INSURANCE

UNIT 12 INSURANCE PRICING AND MARKETING

Structure

12.1 INTRODUCTION

This part identifies the requirements and procedures used to determine insurance prices. Unlike other products, the production cost of an insurance contract is not known in advance. The ultimate cost will be known only in some future date: an inversion of the production cycle. Correct pricing of insurance is therefore the foundation of the existence of insurance contracts and special techniques and methods are developed to price the different insurance products.

The pricing of an insurance contract may be described as the process of calculating the expected claims to be paid and expenses involved in assuming the risk of a defined loss exposure. The prediction of claims is accurate only if there is a proper identification of the risk and a large number of similar loss exposures (characteristics of an ideal insurable risk) to be used to calculate the expected frequency and severity of the losses.

Insurance premiums are generally payable in advance on contracts written for periods of one or three years. The amount of premium written does not become fully earned until the contract has expired. The earned premium represents in an annual contract the same proportion to the total premium written that the period elapsed from the date of issuance of the contract to the end of the year.

12.2. PRINCIPLES OF INSURANCE PRICING AND MARKETING

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Although pricing has become an increasingly critical factor in achieving competitive advantage in the global insurance industry, many companies are still trying to find the right balance in their pricing schemes. Simply put, insurers need a system capable of attracting new business and retaining profitable existing business. But the schemes must also be sufficiently robust to overcome severe cost challenges.

For some companies, the problem is that despite price increases, their systems and processes have not reached a level of sophistication capable of delivering their intended pricing strategy. For others, overcapacity in their markets is driving prices down. One overarching trend, particularly in mature markets, is that customers are increasingly discerning and price sensitive. In addition, the entry of direct players and price aggregators has meant greater transparency, which allows customers to choose the least expensive deal. This transparency has contributed, in particular, to the commoditization of the motor-vehicle insurance industry. Some companies are feeling the effects of many of the above circumstances simultaneously.

Fortunately, there are concrete actions that insurers can take to improve both pricing strategy and price realization. We call these actions the six steps to pricing power in insurance.

Building a Sturdy Pricing Process

In our view, insurers can enhance their pricing capabilities by acting on the following six imperatives:

Improve portfolio price management

Too few insurers have reached their potential in terms of maximizing retention of the most profitable clients and improving the profitability of low-value clients. This goal can be achieved only by gaining a deeper understanding of one's own client base and by developing increasingly granular segmentation. The ability to generate deep client insight from comprehensive data collection is critical, particularly for identifying prospects for cross selling and for adding higher-margin auxiliary coverage alongside principal policies.

Sharpen new-business pricing

Many insurers are tempted to attract clients with initial deep discounts, hoping for price appreciation at renewal time. But this strategy is proving increasingly ineffective. Insurers need to leverage data not only from their own client portfolios but also from a thorough examination of industry wide buying behavior in order to both optimize the pricing of new business and reinforce risk management. Insurers should also incorporate more realistic assumptions into customer lifetime-value projections in order to avoid being taken unawares when customers choose not to renew policies.

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Minimize the variation between list and street prices

Sales forces always have a certain amount of leeway in offering price discounts. But discount budgets are often abused, resulting in a distorted overall pricing structure and the generation of unprofitable portfolios. Minimizing the discrepancies in intended price, rating structure, and actual price is especially important in a business intermediated by agents and brokers. Moreover, the distribution of discount budgets must be controlled and linked to agents' overall performance. Agents who misuse their discount budgets should be penalized by having their pricing discretion curtailed going forward.

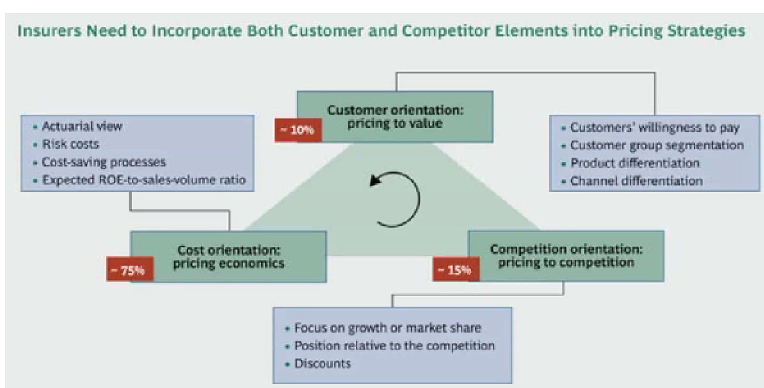
Align distribution objectives with companywide goals and pricing strategy:

Insurers' distribution networks are typically remunerated on the basis of top-line performance only. And in some cases, new business earns higher commissions than renewals. The result of such compensation schemes can be insufficient focus on retention and sales that lack the potential for long-term profitability.

In our client work, we have observed that aligning distribution incentives with organizational objectives is crucial to success. Insurers need to base their design incentives on the bottom line (loss ratio) as well as on the top line. Furthermore, insurers need to provide agents with tools such as alternatives to monetary discounts (including higher deductibles, free supplementary coverage, and vouchers for future renewals) and access to first-rate customer-relationship-management systems that can help them retain their best customers. Agents should also receive regular training updates on how to retain customers and provide the best possible sales experience.

Incorporate customer and competitor elements into pricing

Many insurers are adept at setting cost-oriented pricing structures that are based on claims experience. But few excel at incorporating client price sensitivity and prevailing market prices (those of competitors) into their own pricing. Although some insurers might say that regulations in their market do not allow demand-based pricing or that their agents do not like it, we have seen organizations find innovative ways to work within regulatory frameworks, ultimately earning returns of up to 5 percent of gross written premiums.



Strengthen the organization's infrastructure

To ensure that pricing initiatives can evolve smoothly, insurers need to put in place "enabling" organization structures and processes. These should include a strong actuarial team, as well as sharp managerial oversight capable of translating the business strategy into a disciplined pricing strategy. Most insurers need a step change in pricing processes, including better dialogue among actuarial, marketing, and senior-management teams—with the last being truly able to understand, monitor, and critique the work of the actuaries. In addition, insurers need more frequent and dynamic updates to their pricing systems. Updating, in many cases, involves a fair amount of organizational courage and willingness to try new systems, conduct pricing tests, and stretch boundaries in terms of common practices. **Doing it Right**

Some insurers are ahead of the curve in developing pricing systems that strike an effective and efficient balance. They achieve sufficient margin, overcome cost pressures, and at the same time attract new customers first-time buyers and those previously served by competitors and retain the best existing customers. Such companies tend to have systems and methods that have emerged as best practices in the industry.

For example, some insurers have developed and integrated elasticity curves into their pricing systems for several hundred micro segments in motor vehicle insurance. Such players are able to optimize micro segment-level pricing decisions on the basis of sophisticated analysis of the micro segment's attractiveness, its historic behavior in response to price increases, and competitors' previous pricing moves.

In a similar vein, our client work and proprietary research have enabled us to develop a customer insight methodology aimed at identifying customers' rationales and decision-making processes in purchasing or renewing insurance with possible behaviors segmented into what we refer to as customer "pathways." The pathway choice can depend on a variety of factors, such as how and when the customer becomes aware of a price increase and whether the increase is expected. Applied to a motor-vehicle insurance portfolio, pricing decisions can be optimized if insurers anticipate the likely reactions of each customer to a price increase or decrease at renewal time. Such knowledge helps insurers tightly manage the tradeoff between premium increases and customer churn.

We have seen that customer reactions can be segmented along a few typical pathways. Each pathway presents contrasting elasticity curves, allowing for differences among customers with distinct characteristics normally used to assess technical risks such as the type of motor vehicle, age of the driver, and frequency of claims filing. By incorporating behavioral data into pricing decisions, insurers can generate significant impact: up to 3% in premium increases (with a given churn rate) or a reduction, by one-third, in departing customers as a result of a given average premium increase.

Insurers that take the initiative to address the many pricing-related challenges will very likely find themselves benefiting from their efforts in the years to come. They will be surer of having a finger on the pulse of their customers and will be well positioned to react with pricing moves. They will also know which moves will bring the best net result. Insurers that fail to take action may end up playing a guessing game that will diminish their pricing power going forward.

12.3. TOOLS AND TECHNIQUES USED IN PRICING INDIVIDUAL LIFE AND HEALTH INSURANCE

Rate making is the determination of what rates, or premiums, to charge for insurance. A rate is the price per unit of insurance for each exposure unit, which is a unit of liability or property with similar characteristics.

Insurance Premium = Rate ×Number of Exposure Units Purchased

The difference between the selling price for insurance and the selling price for other products is that the actual cost of providing the insurance is unknown until the policy period has lapsed. Therefore, insurance rates must be based on predictions rather than actual costs. Most rates are determined by statistical analysis of past losses based on specific variables of the insured. Variables that yield the best forecasts are the criteria by which premiums are set. However, in some cases, historical analysis does not provide sufficient statistical justification for selling a rate, such as for earthquake insurance. In these cases, catastrophe modeling is sometimes used, but with less success. Actuaries set the insurance rate based on specific variables, while underwriters decide which variables apply to a specific insurance applicant.

Because an insurance company is a business, it is obvious that the rate charged must cover losses and expenses, and earn some profit. But to be competitive, insurance companies must also offer the lowest premium for a given coverage. Moreover, all states have laws that regulate what insurance companies can charge, and thus, both business and regulatory objectives must be met.

The primary purpose of ratemaking is to determine the lowest premium that meets all the required objectives. A major part of ratemaking is identifying every characteristic that can reliably predict future losses, so that lower premiums can be charged to the low risk groups and higher premiums charged to the higher risk groups. By offering lower premiums to lower risk groups, an insurance company can attract those individuals to its own insurance, lowering its own losses and expenses, while increasing the losses and expenses for the remaining insurance companies as they retain more of the higher risk pools. This is the reason why insurance companies spend money on actuarial studies with the objective of identifying every characteristic that reliably predicts future losses.

Note that both the ratemaking and the underwriting must be accurate. If the rate is accurate for a particular class, but the underwriter assigns applicants that

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do not belong to that class, then that rate may be inadequate to compensate for losses. On the other hand, if the underwriting is competent, but the rate is based on an inadequate sample size or is based on variables that do not reliably predict future losses, then the insurance company may suffer significant losses.

The pure premium, which is determined by actuarial studies, consists of that part of the premium necessary to pay for losses and loss related expenses. Loading is the part of the premium necessary to cover other expenses, particularly sales expenses, and to allow for a profit. The gross rate is the pure premium and the loading per exposure unit and the gross premium is the premium charged to the insurance applicant, and is equal to the gross rate multiplied by the number of exposure units to be insured. The ratio of the loading charge over the gross rate is the expense ratio.

Pure Premium = Losses / Exposure Units

Gross Rate = Pure Premium + Load

The loading charge consists of the following:

- *Commissions and other acquisition expenses*
- *Premium Taxes*
- *General administrative expenses*
- *Contingency allowances*
- *Profit*

Loading charges are often expressed as a proportion of premiums, since they increase proportionately with the premium, especially commissions and premium taxes. Hence, the loading charge is often referred to as an expense ratio. Therefore, the gross rate is expressed as a percentage increase over the pure premium:

$$\text{Gross Rate} = \frac{\text{Pure Premium}}{1 - \text{Expense Ratio}}$$

Gross Premium = Gross Rate × Number of Exposure Units

Expense Ratio = Load / Gross Rate

Other business objectives in setting premiums are:

- Simplicity in the rate structure, so that it can be more easily understood by the customer, and sold by the agent;
- Responsiveness to changing conditions and to actual losses and expenses; and
- Encouraging practices among the insured that will minimize losses.

The main regulatory objective is to protect the customer. A corollary of this is that the insurer must maintain solvency in order to pay claims. Thus, the 3 main regulatory requirements regarding rates is that:

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- They be fair compared to the risk;
- Premiums must be adequate to maintain insurer solvency; and
- Premium rates are not discriminatory the same rates should be charged for all members of an underwriting class with a similar risk profile.

Although competition would compel businesses to meet these objectives anyway, the states want to regulate the industry enough so that fewer insurers would go bankrupt, since many customers depend on insurance companies to avoid financial calamity.

The main problem that many insurers face in setting fair and adequate premiums is that actual losses and expenses are not known when the premium is collected, since the premium pays for insurance coverage in the immediate future. Only after the premium period has elapsed, will the insurer know what its true costs are. Larger insurance companies have actuarial departments that maintain their own databases to estimate frequency and the dollar amount of losses for each underwriting class, but smaller companies rely on advisory organizations or actuarial consulting firms for loss information.

Rate Making for Life Insurance

Rate making for life insurance is much simpler, since there are mortality tables that tabulate the number of deaths for each age, which includes a population of many people. Age is the most important factor in determining life expectancy, but there are other well known factors that have a significant effect, such as the sex of the individual and smoking. Thus, an actuary can reasonably estimate the average age of death for a group of 25-year old males, who don't smoke.

The simplest case is determining the net single premium, which is the premium that would need to be charged to cover the death claim, but does not cover expenses or profit. Although most people don't pay a single premium because of the cost, all life insurance premiums are based on it. Annual level premiums can easily be calculated from the net single premium. The net single premium is simply the present value of the death benefit. The net single premium is less than the death benefit because interest can be earned on the premium until the death benefit is paid. The gross premium for life insurance includes the premium to cover the death claim plus all expenses, a reserve for contingencies, and profit.

Check Your Progress

1. What is meant by insurance pricing?
2. Give the meaning of term 'Rate making'
3. What do you understand by pure premium?
4. What is Rate making for life insurance?

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12.4 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. The pricing of an insurance contract may be described as the process of calculating the expected claims to be paid and expenses involved in assuming the risk of a defined loss exposure.
2. Rate making is the determination of what rates, or premiums, to charge for insurance.
3. The pure premium, which is determined by actuarial studies, consists of that part of the premium necessary to pay for losses and loss related expenses.
4. Rate making for life insurance is much simpler, since there are mortality tables that tabulate the number of deaths for each age, which includes a population of many people.

12.5. SUMMARY

In this unit, you have learnt about the insurance pricing and making, principles of insurance pricinng and marketing, tools and techniques used in pricing individual life and health insurance. The insurance industry in India has changed rapidly in the challenging economic environment throughout the world. In the current scenario, Indian insurance companies have become competitive in nature and are providing appropriate distribution channels to get the maximum benefit and serve customers in manifold ways.

"Health coverage to all" should be the motto of the health insurance sector. There should be easy access to healthcare facilities and cost control measures should be in place. Health insurance is going to develop more in the current liberal economic scenario. But, a completely unregulated or very less regulated health insurance sector may concentrate only on those who have the ability to pay for the insurance cover. So, the challenge is in helping the benefits percolate to the economically weaker sections of the population. Transparent and accountable government and non-government participation should be encouraged. Developing and marketing social health insurance schemes through cooperatives and rural association would go a long way in benefiting the vast unorganized employment sectors currently neglected under the existing schemes. Also a thorough revamp of schemes like Employment State Insurance Scheme (ESIS) and CGHS is necessary for them to be more purposeful and efficient.

If the government, service provider, health care industry and the health insurance customers can incorporate all these suggestions given in the study, then the concept of health insurance will reach new heights in the near future and Mother India will be definitely, the healthiest nation in the world.

12.6. KEY WORDS

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- **CGHS:** CGHS is a special health scheme for the government employees. The medical facilities are provided through Wellness Centres (previously referred to as CGHS Dispensaries) / polyclinics under Allopathic, Ayurveda, Yoga, Unani, Sidha and Homeopathic systems of medicines
- **ESI :** Employees' State Insurance (abbreviated as ESI) is a self-financing social security and health insurance scheme for Indian workers. The fund is managed by the Employees' State Insurance Corporation (ESIC) according to rules and regulations stipulated in the ESI Act 1948
- **Rate making:** The determination of what rates, or premiums, to charge for insurance.
- **Pure premium:** Is determined by actuarial studies, consists of that part of the premium necessary to pay for losses and loss related expenses.
- **Insurance Prices:** The requirements and procedures used to determine insurance prices.

12.7. FURTHER READINGS

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12.8. SELF-ASSESSMENT QUESTIONS AND EXERCISES

NOTES

Short Questions

1. What is meant by insurance pricing
2. Give the meaning of term 'Rate making'
3. What do you understand by pure premium
4. What is Rate making for life insurance

Big Questions

1. What are the principles of insurance pricing and marketing
2. Explain the techniques used in pricing life insurance
3. Discuss the health insurance

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UNIT 13 FINANCIAL MANAGEMENT IN INSURANCE COMPANIES AND INSURANCE OMBUDSMAN

Structure

13.1 INTRODUCTION

The new solvency regime Solvency II represents a solid and harmonized prudential framework applicable by insurance companies in the European area. Solvency II was implemented in the European Union by adopting Directives 2009/138/EC respectively 2014/51/EU, replacing existing directives regulating solvency former regime, known as Solvency I. Thus, the new European legislation in insurance, applicable from 1 January 2016, was aimed at unifying the main European insurance market and ensuring consumer protection. The responsible authority at EU level with the implementation of the new solvency regime is EIOPA - European Insurance and Occupational Pensions Authority, which dealt in previous periods of testing the European market insurance through organizing quantitative impact studies (last exercise - QIS5, organized in 2011). The main standards derived from Solvency II and also the new IFRS accounting provisions, intended to increase the transparency of risk management and investment, in order to pricing insurance products and profitability of the different classes of insurance rates. Solvency II brings both challenges and opportunities for companies, changing the concept of building protection programs for insured and generating additional concerns about capital requirements in the determination of own funds (basic, auxiliary and surplus) that can be used to meet this requirement. Also estimate realistic and prudent risk assumed by insurance contracts concluded transposed to the insurance companies by recording every technical reserves represent a very important element in order to establish an optimal balance of financial resources. Given the significant overlap

between IFRS and Solvency II, insurers will have to improve disclosure requirements of additional information and adjust planning and forecasting. All these measures will increase the efficiency of financial management, a series of operational measures and by providing documented and tested processes. Also, increasing volatility related to financial results will cause insurance companies to deliver predictable results, a process that will produce changes in the financial management optics

Treatment of IFRS standards and Solvency II

Directive 2009/138/EC, which was adopted and implemented new solvency in the insurance field, has regulated general directions regarding: access and performance, supervision of groups, reorganization and liquidation of insurance companies.

Also, in order to carry on insurance business, reinsurance, as well as calculating solvency capital requirements, the directive established by regulations on new rules:

- Balance sheet valuation of assets and liabilities;
- Technical reserves calculation and recording;
- Determination, classification and eligibility of own funds;
- Investment.

Measuring assets and liabilities balance sheet is carried at the amount that could be traded / transferred / settled related items between stakeholders, voluntarily and knowingly, in objective conditions and normal competition.

The amount of technical reserves (VRT), calculated in a prudent, reliable and objective manner, consists of the average of future cash flows, weighted by the probabilities of achievement (BE - best estimate) and of the risk margin (MR) - in order to honor the obligations of insurance-reinsurance:

$$VRT = BE + MR$$

The new provisions establish the calculation of own funds of insurance companies as follows:

Equity base (FPB) - composed of surplus assets over liabilities and of subordinated liabilities;

Ancillary own funds (FPA) - consisting of equity, guarantees and commitments legally binding;

Surplus funds (FSP) - accumulated profits for clients and beneficiaries.

Equity component is represented by the following formula:

$$FP = FPA + FPB$$

The importance of determining the own funds of insurance companies, resides in the classification of these funds based on tiers, as follows:

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- Funds rank 1 (R1) - including the FPB and FSP available and priority;
- Funds rank 2 (R2) - including the FPB and FPA due priority;
- Funds rank 3 (R3) - the remaining funds.

Consequently, the new regulations had an impact both on the valuation of balance sheet items of insurance companies, reinsurance, crossing it in terms of operational and functional with the accounting for those items and also how to exercise financial management.

The main concerns standard insurance and reinsurance market is represented by IFRS 4 - Insurance Contracts, adopted in March 2004 by the IASB *(IFRS,IFRS Foundation, 2013)*. The standard applies to all insurance and reinsurance contracts that the entity issues and reinsurance contracts that it owns and provides: - Conduct tests as follows:

- Test for adequacy of recognized insurance liabilities relating to contracts;
- Impairment test for reinsurance assets associated with the contract.
- Presentation of information to help users understand the value of the insurer's financial statements arising from insurance contracts and the nature and extent of risks arising from insurance contracts.

Regarding the adequacy test debt, insurers must assess at the end of each reporting period whether debt related to insurance contracts recognized are adequate, using current estimates of future cash flows related to insurance contracts, and if the assessment shows that the carrying value of debt associated insurance (minus deferred acquisition costs and related intangible assets) is inadequate, the entire deficiency shall be recognized in profit or loss

Insurance Ombudsman

The Insurance Ombudsman scheme was created by the Government of India for individual policyholders to have their complaints settled out of the courts system in a cost-effective, efficient and impartial way. There are at present 17 Insurance Ombudsman in different locations and any person who has a grievance against an insurer, may himself or through his legal heirs, nominee or assignee, make a complaint in writing to the Insurance ombudsman within whose territorial jurisdiction the branch or office of the insurer complained against or the residential address or place of residence of the complainant is located.

Approach the Ombudsman with complaint

You have first approached your insurance company with the complaint and

- They have rejected it
- Not resolved it to your satisfaction or
- Not responded to it at all for 30 days
- Your complaint pertains to any policy you have taken in your capacity as an individual and

- The value of the claim including expenses claimed is not above Rs 30 lakhs.

Your complaint to the Ombudsman can be about:

- Delay in settlement of claims, beyond the time specified in the regulations, framed under the IRDAI Act, 1999.
- Any partial or total repudiation of claims by the Life insurer, General insurer or the Health insurer.
- Any dispute about premium paid or payable in terms of insurance policy
- Misrepresentation of policy terms and conditions at any time in the policy document or policy contract.
- Legal construction of insurance policies in so far as the dispute relates to claim.
- Policy servicing related grievances against insurers and their agents and intermediaries.
- Issuance of life insurance policy, general insurance policy including health insurance policy which is not in conformity with the proposal form submitted by the proposer.
- Non issuance of insurance policy after receipt of premium in life insurance and general insurance including health insurance and
- Any other matter resulting from the violation of provisions of the Insurance Act, 1938 or the regulations, circulars, guidelines or instructions issued by the IRDAI from time to time or the terms and conditions of the policy contract, in so far as they relate to issues mentioned at clauses (a) to (f)

THE SETTLEMENT PROCESS

Recommendation:

The Ombudsman will act as mediator and

- Arrive at a fair recommendation based on the facts of the dispute
- If you accept this as a full and final settlement, the Ombudsman will inform the company which should comply with the terms in 15 days

Award:

If a settlement by recommendation does not work, the Ombudsman will:

- Pass an award within 3 months of receiving all the requirements from the complainant and which will be binding on the insurance company

Once the Award is passed

The Insurer shall comply with the award within 30 days of the receipt of award and intimate the compliance of the same to the Ombudsman.

13.2. IMPORTANCE OF FINANCIAL MANAGEMENT IN INSURANCE COMPANIES

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In modern conditions of substantial uncertainty of world economic development, the role of insurance in financial protection of economic entities and the population against unexpected losses is increasing. In this situation, the prediction of the magnitude of the financial resources for the implementation of the planned strategic activities of insurance organizations on the prospect becomes one of the most important areas, ensuring the continuity of their operation in a long period. In this regard, the issues of formation and implementation of their financial strategy gain special relevance for strengthening of a role of the insurance market in national economy of the Republic of Belarus, which, despite the positive dynamics of its development, is still lagging behind the global average achievements.

The objective need of constructing and implementing a financial strategy for any subject is caused by the necessity of determining the financial capacity to carry out all the activities planned by its corporate strategy for prospect. Thus, financial strategy acts as one of the most important parts of the general strategy of development of the company in the form of financial support strategic objectives. Its main purpose consists of justification of steady financial base and rational distribution of its resources that positively influences continuous and productive functioning of firm in the commodity and financial markets.

The successful solution of strategic tasks assumes that financial strategy defines forecasts of the priority financial indicators that are characterizing:

- Circulation of financial resources in the form of input financial flows reflecting size of the mobilized funds and sources of income;
- The volume and structure of output financial flows – target use of financial resources taking into account achievements of economic and social benefit;
- The set of economic relations between the participants in the reproduction process in the accumulation and use of financial resources;
- Scientific tools, including strategic planning, maneuvering financial resources, their correction based on an assessment of their intended purposes at all stages of the functioning of financial strategy, taking into account the major changes in the external and internal situation.

These and other features of the financial strategy of an economic entity allowed to clarify the term and the conceptual basis of its formation.

In our opinion, financial strategy should be considered as a complex program of justification of the predicted parameters of volume and structure of the input and output financial flows of the subject, providing implementation of strategic objectives of its development for achievement of financial safety and competitiveness in a long period of time. For reliability of the developed financial strategy it is necessary to adapt it for peculiarities of activity of the specific subject, to identify

conditions of its production and financial resources and to evaluate the current trends in the decisive performance in the past period, and also to consider extent of development of the national insurance market and influence of the other factors.

Mechanism of realization of insurers' financial strategy

The final stage of the formation model of financial strategy is its implementation mechanism, which is to become a tool for conscious management of relevant cash flows by means of taking active management decisions, the use of financial incentives, sanctions, threshold standards, assessment of effective decision-making and other methods that facilitate the successful solution of strategic objectives. For this purpose, the algorithm of implementation mechanism of financial strategy is developed. It includes the adjustment of relevant financial indicators, taking into account the major changes in the external and internal environment of insurers, as well as the accomplishment of the tasks intended for the past period. In order to optimize insurance services structure, it is essential to construct matrixes of major types of insurance incomes and risks, taking into account increase in profits and the level of common profitability. Construction of matrixes of major types of insurance incomes and risks, taking into account increase in profits and the level of common profitability, is essential for optimization of insurance services structure.

13.3. TOOLS OF MANAGING EXPENSES IN THE INSURANCE COMPANIES

The Insurance Regulatory and Development Authority of India (IRDAI) has brought out a new set of norms on expenses of management for general insurance and standalone health insurance companies, based on the line of business. These take effect from this financial year. In the segments of motor, health retail and miscellaneous retail (like public liability), the expenses allowed are higher. There would be penalties if the expense limits are exceeded. Expenses of management would include all those in the nature of operating expenses commission, brokerage, remuneration to agents and to intermediaries, charged to the revenue account.

No general insurance or health insurance business can exceed the amount stipulated. In motor insurance, the allowable expense is 37.5 per cent of gross premium for the first Rs 500 crore. It is 32.5 percent for the next Rs 250 crore and 30 per cent for the balance. Any violation of the limits on an overall basis could even lead to restriction on performance incentives for the managing director, chief executive officer, whole time directors and key management. Also, possible restrictions on opening of new places of business and removal of managerial personnel and/or appointment of administrator.

IRDAI said it may also direct the insurer to not underwrite new business in one or more segments in case of persistent violation of these regulations. It has also asked insurers to ensure that at the segment level, the deviation between actual incurred claim ratio and that projected at the time of filing of a product be not more than 10 percent.

If there be a deviation higher than this over a period of three years, an exception report and a plan of action, specifying the reasons, has to be sent to it.

The expense ratio in the insurance industry is a measure of profitability calculated by dividing the expenses associated with acquiring, underwriting, and servicing premiums by the net premiums earned by the insurance company. The expenses can include advertising, employee wages, and commissions for the sales force. The expense ratio signifies an insurance company's efficiency before factoring in claims on its policies and investment gains or losses. The expense ratio is combined with the loss ratio to give an insurance company's combined ratio.

Two Different Methods

There are two ways to calculate expense ratios. Insurance companies typically use statutory accounting as opposed to generally accepted accounting principles (GAAP) accounting to calculate their expense ratios, as statutory accounting yields more conservative ratios. Although the expenses are the same in both ratios, statutory accounting uses the net premiums written during the period in the denominator to get the expense ratio.

GAAP accounting uses the net premiums earned during the period. Net premiums written are the new business brought in by the company, while net premiums earned may include both new business and recurring business from existing policies.

A Precursor to Overall Profitability The expense ratio can be used to compare companies and analyze a company's performance over time. An expense ratio under 100% signifies the insurance company is either earning or writing more premiums than it is paying out in expenses to generate and/or support these premiums. Although its expense ratio can be stellar, the overall profitability of an insurance company is affected by its loss ratio, investment income, and other gains and losses. Thus, the expense ratio is not a measure of ending profitability. Instead, it is a precursor to finding an insurance company's overall profitability.

13.4. MODES USED BY THE INSURANCE COMPANIES IN CHANNELIZING THEIR FUNDS

When you purchase life insurance, you agree to pay a specific sum of money, or premium, to the insurance provider at regular intervals. The frequency or period of your payments depends on your mode of premium. Most insurance providers offer several modes of premium, the most common of which come annually, semi-annually, quarterly, or monthly. The mode of premium payment is not the same as your mode of payment. Your mode of premium payment determines the frequency with which payments are made. It also determines the way in which you make payments, such as by cash, check, credit card, or another option.

Understanding Mode of Premium

Policyholders select their mode of premium when they sign their policy. It is common practice to make your first premium payment to activate the coverage on your policy. The insurance agent should highlight the possible frequency of premium payments before you sign your policy.

Many insurers allow policyholders to change the mode of premium to a higher or lower frequency during the life of the policy. Dates of change normally coincide with pre-existing payment dates, meaning if you want to change from a semi-annual to a monthly premium, then you will likely make your first monthly payment on the date of your next scheduled semi-annual payment. The payment schedule would switch to monthly from that point forward.

Impacts of Mode of Premium

As a general rule, more frequent modes of premium payment tend to cost less per payment. However, more frequent payments also tend to cost more in total. For instance, an insurer might charge you $150 per month, $400 per quarter, $700 per semi-annual payment or $1,250 per year for your policy.

The up-front costs of the annual payment are much higher than the others, but it is actually the cheapest mode for an entire year's worth of coverage. The monthly, quarterly and semi-annual modes would cost $1,800, $1,600, or $1,400 per year, respectively, versus the $1,250 annual payment.

The reason more frequent payment modes tend to cost more is that insurance companies need to offset the uncertainty and higher collection costs. Imagine you are the insurance provider you are very likely to place added value on receiving a full year's worth of payments up front, because this means you have to worry about fewer late or missing payments in the future.

Higher payments improve cash flow right away and make it easier to predict your future financial status. You can also use the extra money to make larger, earlier investments. Think of modes of payments like the payments on a loan. In a loan scenario, borrowers who take a long time to pay back their principal usually end up paying more in interest.

Similarly, the longer it takes policyholders to pay the full cost of their annual life insurance coverage, the more it costs. Life insurance is not a debt and policyholders are not borrowers, but the relationships between time and cost of payment are comparable. Some insurance providers even offer an annual percentage rate (APR) calculator on their website to see how mode of premium payment influences the final cost.

Selecting Your Mode of Premium

To secure the lowest overall cost for your life insurance, pick a less frequent mode of premium payment. Ignoring other considerations, the annual costs of less-frequent payment modes are often substantially discounted when compared to more frequent modes.

Do not forget to consider two factors

Opportunity costs and liquidity. Your liquidity is the amount of cash you have ready to make premium payments. If you only have $50 in the bank, it is probably unwise to choose a $1,250 annual premium payment option.

Even if you have the money for an annual payment, the opportunity cost of choosing a $1,250 annual payment over a $150 monthly payment is everything else you could have done with $1,100 in the short term. It may be possible to invest that money and earn more than the added cost of the monthly payment option.

Another consideration is that, if you terminate your policy early, many insurance providers do not refund portions of premiums already paid. Suppose you purchase life insurance and pay an annual premium on Jan. 10. Unfortunately, your insurable interests change midyear, and you decide to terminate your contract on July 10. Even though you only used 50% of your annual coverage, your insurance provider does not have to refund you the remaining 50%.

How Do Insurance Companies Invest Money?

Insurance companies invest in many areas, but most of all they invest in bonds. This makes sense because bonds are perhaps the safest of all investment categories. Insurance companies being in the business of risk assessment would logically find the low risk that bonds represent appealing, but there are other reasons as well.

Insurance companies tend to invest the most money in bonds, but they also invest in stocks, mortgages and liquid short-term investments.

Breaking the Insurance Business Down

Insurance is the redistribution of risk. Simplifying a bit, you can construct a hypothetical insurance company with a hundred commercial building clients, each with a single building worth $1 million (this, by the way, would be an unreasonably small company if it were real). Applied mathematicians and statisticians called actuaries use their skills to make reasonable assessments of the probability of each of these companies having a total loss in a given year (again, in reality, the assessment would cover various levels of loss). They find that each of these companies has a 1 percent chance of a total loss.

How Insurance Companies Make Money

Conveniently for present purposes, this means that the probability (but not the certainty) is that overall the hypothetical insurance company will have total losses in the given year of $1 million 1 percent risk per building times 100 $1M buildings is equivalent to one $1M building times 100 percent.

To make money, the insurance company has to charge each building client enough for their insurance to pay off the probable $1 million loss, plus some additional amount calculated by its actuaries to take into account less probable outcomes and finally another amount that represents the desired profit. For purposes

of illustration, you could assume the company needs to take in total premiums of $3 million.

Why Insurance Companies Invest

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It would be possible for the insurance company to take the $3 million premium money received and just stick it in a safety deposit vault. It would also be a bad idea, because there are reasonable ways of investing that money to make more money. Investing the premiums does two good things: it increases the insurance company's profits and makes it possible for the company to lower its premium amounts, making its policies more attractive to clients.

What Insurance Companies Invest in

Insurance companies could invest in the stock market, and in fact they do, but investing in the stock market alone would be too risky because it's a cyclical market that swings from high bull market returns to considerable bear market losses. An insurance company has to know with a high degree of certainty that overall in any given year they're not going to absorb an unsustainable loss; therefore stocks can only represent a relatively small portion of their investment portfolios. For life insurance companies, stock market investments represent around 5 percent of total holdings. Property and casualty insurance companies usually invest around 30 percent of holdings in common stocks.

The appeal of bonds is that they provide a much more predictable future cashflow, but also investment grade bonds return markedly less on average than the long-term return of the stock market. In 1928, $100 invested in the stock market would have grown to more than $320,000; the same amount invested in investment grade and treasury bonds would have grown to $7,000. By investing only a portion of their premiums in the riskier stock market, they still participate to some extent in its higher returns, but without assuming the full risk of the stock market's volatility.

Diversification of Risk

One or more reason for insurance companies to invest in both stocks and bonds rather than bonds alone: the two investment classes are only weakly correlated. They tend to rise and fall somewhat loosely together, but not exactly. Nevertheless, there is some correlation.

An ideal third investment choice for insurance companies would be another relatively low risk that's uncorrelated in other words, an investment whose returns are independent. In fact, investment in the mortgage market, which is relatively uncorrelated, accomplishes just that. The life insurance sector of the insurance market invests about 15 percent of its premiums in mortgages and first liens. These three asset classes bonds, stocks and mortgage instruments comprise about 90 percent of investments for life insurance companies and over 80 percent of investments for property and casualty insurers.

The fourth largest asset class consists of highly liquid short-term investments and cash, totaling about 5 percent of investments for life insurers and about 10 percent for insurers in the somewhat more volatile property and casualty business. Beyond this, insurance companies invest in areas that include derivatives (contracts with values dependent upon other assets, often mortgages), contract loans, securities lending, real estate and preferred stock (which perform more like bonds than common stock). But all these areas together total only about 10 percent of life insurance company investments and slightly more than that for property and casualty insurers. An important function of these other, relatively minor investments is to provide additional diversification of risk.

Check Your Progress

1. What do you understand by new solvency regime Solvency II?
2. What is insurance ombudsman?
3. Write short note on implementation of financial strategy.
4. State any three treatment of IFRS standards and Solvency II.

13.5 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. The new solvency regime Solvency II represents a solid and harmonized prudential framework applicable by insurance companies in the European area.
2. The Insurance Ombudsman scheme was created by the Government of India for individual policyholders to have their complaints settled out of the courts system in a cost-effective, efficient and impartial way.
3. Financial strategy is its implementation mechanism, which is to become a tool for conscious management of relevant cash flows by means of taking active management decisions, the use of financial incentives, sanctions, threshold standards, assessment of effective decision-making and other methods that facilitate the successful solution of strategic objectives.
4. Insurance business, reinsurance, as well as calculating solvency capital requirements, the directive established by regulations on new rules:
   - Balance sheet valuation of assets and liabilities;
   - Technical reserves calculation and recording;
   - Determination, classification and eligibility of own funds;

13.6. SUMMARY

In this unit, you have learnt about the financial management in insurance companies and insurance ombudsman, importance of financial management, tools of managing

expenses and modes used by the insurance companies in channelizing their funds.

The structure on the eligibility of own funds imposed by Solvency II, and treatment of financial instruments in general or investment component separation of insurance products for IFRS will generate changes in optics financial management at insurance companies. The situation presented above, which shows a concentration of investments in the balance sheets of insurance companies exceeding 50%, demonstrates on the one hand concern the insurance industry in the financial activity and investment, and on the other hand ensuring a stable foundation in order to cover capital requirements imposed by Solvency II regime. However, both these requirements, and the requirements of IFRS standards on transparency and information to end users, will force management insurance companies to increase the quality of portfolio investment, in the sense of providing funds you should not be exposed to excessive market risks. In conclusion, financial management at insurance companies will increase in importance in the coming period, growth due to both changes imposed by the new regulations on Solvency II and IFRS and also because of the transformation and modernization of the insurance business, by the interdependence of this sector with investment activity.

The considered questions of formation and realization of financial strategy of insurance companies are directed on improvement of strategic management quality of financial and economic activity of insurers and strengthening of their active impact on acceleration of growth rates of economy and welfare of the population.

13.7 KEY WORDS

- **New Solvency:** New solvency in the insurance field, has regulated general directions regarding: access and performance, supervision of groups, reorganization and liquidation of insurance companies.
- **EIOPA:** European Insurance and Occupational Pensions Authority
- **Insurance Ombudsman:** Policyholders to have their complaints settled out of the courts system in a cost-effective, efficient and impartial way.
- **IRDAI:** The Insurance Regulatory and Development Authority of India
- **GAAP:** Generally Accepted Accounting Principles
- **Financial Strategy:** Its implementation mechanism, which is to become a tool for conscious management of relevant cash flows by means of taking active management decisions, the use of financial incentives, sanctions, threshold standards, assessment of effective decision-making and other methods
- **IFRS:** International Financial Reporting Standards

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13.8 FURTHER READINGS

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13.9 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. What do you understand by new solvency regime Solvency II
2. What is insurance ombudsman
3. Write short note on implementation of financial strategy
4. How Insurance Companies Make Money
5. How Do Insurance Companies Invest Money?

Big Questions

1. Explain the financial management in insurance companies
2. What are the importance of financial management in insurance companies
3. Discuss the tools of managing expenses in insurance companies
4. What modes used by the insurance companies in channelizing their funds

UNIT 14 REINSURANCE

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Structure

14.1 INTRODUCTION

It is a process whereby one entity (the reinsurer) takes on all or part of the risk covered under a policy issued by an insurance company in consideration of a premium payment. In other words, it is a form of an insurance cover for insurance companies.

Unlike co-insurance where several insurance companies come together to issue one single risk, reinsurers are typically the insurers of the last resort. The insurance business is based on laws of probability which presupposes that only a fraction of the policies issued would result in claims. As a result, the total sum insured by an insurance company would be several times its net worth. It is based on this same probability of loss that insurance companies fix the insurance premium. The premiums are fixed in such a manner that the total premium collected would be enough to pay for the total claims incurred after providing for expenses.

However, there is a possibility that in a bad year, the total value of claims may be much more than the premium collected. If the losses are of a very large magnitude, there is a chance that the net worth of the company would be wiped out. It is to avoid such risks that insurance companies take out policies. Secondly, insurance companies take the support of reinsurers when they do not have the capacity to provide a cover on their own. Broadly, reinsurance can be classified under two heads - treaty reinsurance and facultative reinsurance.

- **Treaty reinsurance** agreements cover all or a portion of an insurer's risks, and they are effective for a certain time period.
- **Facultative coverage** insures against a specific risk factor. The underwriter would evaluate the individual risk factor and write a policy accordingly.

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14.2. REINSURANCE IN THE INSURANCE SECTOR

Reinsurance, commonly referred to as "insurance for insurers," is the transfer from one insurer (the primary insurer) to another (the reinsurer) of some or all of the financial consequences of certain loss exposures covered by the primary insurer's policies. The loss exposures transferred, or ceded, by the primary insurer could be associated with a single subject of insurance (such as a building), a single policy, or a group of policies.

An insurer that transfers liability for loss exposures by ceding them to a reinsurer can be referred to as the reinsured, the ceding company, the cedent, the direct insurer, or the primary insurer. Although all these terms are acceptable, "primary insurer" will be used to denote the party that cedes loss exposures to a reinsurer.

Reinsurance is transacted through a reinsurance agreement, which specifies the terms under which the reinsurance is provided. For example, it may state that the reinsurer must pay a percentage of all the primary insurer's losses for loss exposures subject to the agreement, or must reimburse the primary insurer for losses that exceed a specified amount. Additionally, the reinsurance agreement identifies the policy, group of policies, or other categories of insurance that are included in the reinsurance agreement.

The reinsurer typically does not assume all of the primary insurer's insurance risk. The reinsurance agreement usually requires the primary insurer to retain part of its original liability. This retention can be expressed as a percentage of the original amount of insurance or as a dollar amount of loss. The reinsurance agreement does not alter the terms of the underlying (original) insurance policies or the primary insurer's obligations to honor them. See the exhibit "Risk."

The primary insurer pays a reinsurance premium for the protection provided, just as any insured pays a premium for insurance coverage, but, because the primary insurer incurs the expenses of issuing the underlying policy, the reinsurer might pay a ceding commission to the primary insurer. These expenses consist primarily of commissions paid to producers, premium taxes, and underwriting expenses (such as policy processing and servicing costs, and risk control reports).

Reinsurers may transfer part of the liability they have accepted in reinsurance agreements to other reinsurers. Such an agreement is called a retrocession. Under a retrocession, one reinsurer, the retrocedent, transfers all or part of the reinsurance risk that it has assumed or will assume to another reinsurer, the retrocessionaire. Retrocession is very similar to reinsurance except for the parties involved in the

agreement. The discussions of reinsurance in the context of a primary insurer-reinsurer relationship also apply to retrocessions.

14.2.1. Reinsurance Functions

Reinsurance helps an insurer achieve several practical business goals, such as insuring large exposures, protecting policyholders' surplus from adverse loss experience, and financing the insurer's growth. The reinsurance that an insurer obtains depends mainly on the constraints or problems the insurer must address to reach its goals. Although several of its uses overlap, reinsurance is a valuable tool that can perform six principal functions for primary insurers:

- Increase large-line capacity
- Provide catastrophe protection
- Stabilize loss experience
- Provide surplus relief
- Facilitate withdrawal from a market segment
- Provide underwriting guidance

Depending on its goals, a primary insurer may use several different reinsurance agreements for these principal functions.

Increase Large-Line Capacity

The first function of reinsurance is to increase large-line capacity, which allows a primary insurer to assume more significant risks than its financial condition and regulations would otherwise permit.

Provide Catastrophe Protection

Without reinsurance, catastrophes could greatly reduce insurer earnings or even threaten insurer solvency when a large number of its insured loss exposures are concentrated in an area that experiences a catastrophe. Potential catastrophic perils include fire, windstorm (hurricane, tornado, and other wind damage), and earthquakes. Additionally, significant property and liability losses can be caused by man-made catastrophes, such as industrial explosions, airplane crashes, or product recalls.

Stabilization of Loss Experience

Reinsurance can be utilized to prevent any "spikes" in loss results from year to year.

Provide surplus relief

Insurers are precluded by rating/regulatory bodies from exceeding certain premium to surplus ratios. However, reinsurance can assist in lowering these leverage ratios (typically on a short term basis) by the cession of premium and risk on a first-dollar basis or via aggregate protection.

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Facilitate withdrawal from a market segment

When withdrawing from a market segment, the primary insurer base these option: Stop writing new insurance policies and continue in force insurance until all policies expire (often referred to as "run-off") Cancel all policies (if regulations permit) and refund the unearned premiums to insured, Withdraw from the market segment by purchasing portfolio reinsurance

Provide underwriting guidance

- Intermediaries and Reinsurance Underwriters Association (IRU)
- Brokers & Reinsurance Markets Association (BRMA)
- Reinsurance Association of America (RAA)

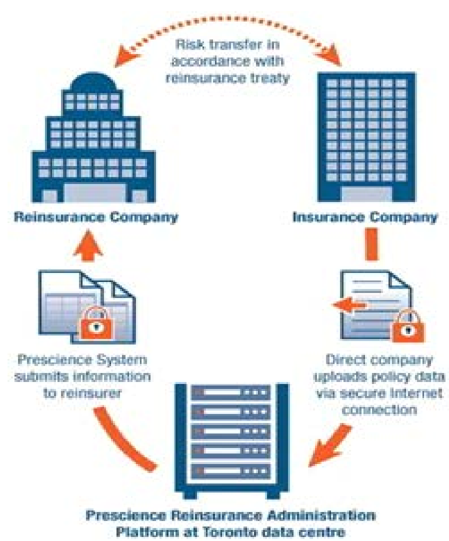
14.3. AREAS OF THE APPLICATION OF REINSURANCE

Indications will now be made as to the proper application of various types of reinsurance in different branches of insurance.

Reinsurance in Fire Insurance Business

The surplus treaty is most widely used. Quota share treaties are used by the newly established companies or with regard to the new business of established companies.

The service of facultative reinsurance is also occasionally utilized, particularly with regard to bigger risks, where the standing treaty arrangement does not provide full automatic protection.



Excess of loss treaties is utilized for catastrophe risks or where there is a possibility of accumulation of risks leading to conflagration fire, or where fire policies provide additional covers such as cyclone, hurricane flood etc.

Reinsurance in Marine and Aviation Insurance Business

Quota share and surplus are quite common even though the facultative method is still very widely used.

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Excess of loss and stop loss arrangements are also made in catastrophe hazards, such as general average, the total loss to hull etc.

Reinsurance in Accident Insurance Business

All types of treaties are commonly used.

In cases of hazardous elements or where accumulation and catastrophe are apprehended or in cases of liability insurances, an excess of loss or stop loss is most favored. Pools are considered in special types of risks, such as crop insurance.

The facultative method is not much used unless the business is beyond the absorption capacity of the treaty.

The facultative method is also used when the ceding company does not wish to interest the treaties for some obvious reasons.

Reinsurance in Life Insurance Business

The most commonly used type is the surplus treaty. The facultative cover is also still in use although in a very limited degree.

Pools are used for various types of impaired lives, such as lives suffering from heart disease, blood pressure, diabetes etc.

14.4. INFORMATION TECHNOLOGY IN INSURANCE

In the present scenario everyone is using computer one way or the other and whenever you go to the market for shopping in any departmental store there you will find billing is computerized. The most common item now a days is a Mobile phone which uses the information technology to send the data or store the data like phone numbers or the messages. In the latest mobile sets songs can also be stored and the mobile phone instrument can be used as computer. The innovation in the computer field is taking at very high pace. Under this chapter we will not teach the working of the computer or any language. We are going to explain how the computer can be useful in the insurance sector.

14.4.1. Meaning of information technology

The devices and techniques used to store, process, manage transit and communicate information, encompass various technologies such as computing, microelectronics and telecommunication is known as Information Technology.

There is revolution in the Information Technology after the advent of computers starting with first Generation Computers to the latest Pentium

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microprocessor based Personal computer. It has been further revolutionized with the development of software packages for specific area from standalone personal Computers to Local Area Network and ~Wide Area Network~ and Main Frame computers. These computers can be used by many users simultaneously known as Multi-user environment.

You know very well that the volume of transaction is very large in any insurance organization. The data and information are to be stored for a Longer period because insurance contracts are long term especially life Insurance contracts. The Insurance organizations have the network all over. the countries even in foreign countries. Moreover, the transactions are of repetitive nature therefore, it has become necessary to seek the help of machines to process the data.

Initially, the Insurance companies used adrena machines and punch card equipment for creating, storing and processing data. But these machines were severely limited in their capacity. These were mechanical machines or Electra mechanical machines therefore, their speed, capacity and flexibility was much limited, But even the computers had some limitations initially, But these difficulties have been overcome with the help of the recent developments in telecommunication, which are used to aid computer technology

14.5. APPLICATION OF INFORMATION TECHNOLOGY IN THE INSURANCE SECTOR

The present scenario is such that the products sold with the help of Internet. The technological advancement is such that force the companies to take such steps. Still the full-fledged use of Internet is not done in our country. As suggestion earlier the Internet based life insurance will help the companies to reduce the transaction cost and time. At the time it can improve the quality of service to its customers, which is the mission of the company.

14.5.1. Life Administration Module

- **Policy Servicing of existing policies**: The existing policyholders may require various services after taking the insurance policy For eg: Change of Nominee, Change of address, of change in mode of payment, assignment of the policy, Claims payment etc. These changes or payment can be made very easily through computers.
- **New Business:** As and when the new business is acquired the initial data of a policyholder is quite large and as stated above the data is to be maintained for longer period therefore storage of data in computer is useful
- **Renewal notice/Billing:** Renewal notices to be sent for the payment of the premium and with a no. of policyholders are very large and the renewal is on different dates. The computer generates the renewal notice at very high speed and does it automatically. The inter-mediatory bills are generated very fast and quickly

- **Loans:** The Policyholders do take loans and the insurer has to maintain the records as the insurer has to recover the loan from the policyholder along with the interest. The recovery of loan may be regular or recovery at the time of payment of claim

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Statistics and MIS Claims

As the data in computer can be stored for longer period the data may be useful for the insurer to prepare the type of policies are sold in the market and type of claim arisen in the particular region. These types of data will be useful for management to take any decision.

Archiving of historical data and imaging Systems

As the past data is available with life insurer therefore they can design the new products and price them accordingly.

14.5.2. General Insurance Applications

a) Front Office System

- Policy Management and underwriting system
- Co-insurance
- Reinsurance
- Claims Management System
- Financial' Accounts and Audit
- Statistics and MIS

b) Reinsurance System

- Inward insurance
- Outward Insurance
- Reinsurance Account
- MIS.

c) Risk Management System

Other Applications

a) Investment

- Term Loan
- Money market
- Investment Accounts
- Market Operations

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b) Personnel System.

- Payroll system
- Performance Appraisals
- Attendance and leave system
- PF

c) Office Services

- Purchases
- Inventory
- Tours and
- Travels etc
- Corporate Accounting System General Insurance Applications

Let us discuss about Front Office System In the General Insurance Industry. These applications can be written in any language and they may differ from Office to Office of The different Insurance Companies. The software namely GENESIS~ is being used by General Insurance Companies. On-line Front Office System is the first step towards computerization of any insurance Company and a well-designed system at the front offices has following advantages to the company

- To carry out business transactions efficiently
- Easy to handle growing volume of business and variety of business (No. of documents processed, Variety of policies issued, Volume of business)
- Efficient customer services
- Reduction in office expenses
- MIS for the Branch Managers

A good Front Office System should allow Insurer, Underwriters, and agents to manage the day to day operations of the office. The system should be capable of administering all stages of policy development from questions to new business, through adjustments by way of endorsements and renewals of policies. Coinsurance, Claims re-insurance and all accounting functions. The main components of the Front office System are given below:

- Policy Management including Underwriting (Policy acceptance and printing and customer services)
- Co-insurance
- Re-insurance.
- Claims.
- Statistics & MIS
- Accounts

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Policy management including underwriting

Policy Management has provisions for policy acceptance, client interaction window and policy printing. They should be able to store policies and the system should allow immediate access to a client portfolio. The policy management system generally has provisions for dealing directly through a broker or an agent or branch office. Generally in a good Policy Management system The Policy" is able to handle multiple and mixed risks even if these risks are located at multiple locations. Policy management system has following additional features:

- User configured screens
- Provision for questions
- Policy production (including printing)
- Renewals
- Endorsements
- Coinsurance

The front office system should have the facility to handle Coinsurance policies. The provisions should be such that underwriter simply states whether the insurer is acting as lead insurer or follower. They should then automatically pass the retained premium to the relevant reinsurance. Claims payment should activate co-insurer recoveries wherever necessary.

Reinsurance

The Front Office system generally has facility to handle all types of proportional reinsurance including Surplus and Quota Share Treaties: The system should be capable of setting up treaty layers by class of business with exposure levels varied according to the EML (estimated maximum ion). The system generally has the provision to incorporate proportional reinsurance ceding automatically into any claim payments or recoveries. The reinsurance module automatically produces reinsurance Bordeaux for each cedant.

Claims

The Front Office System includes an integrated claims system to record, progress and monitor claims, experience by Policy Clients brokers, Branch and risk covered. Some of the features of a claims module are given below

- Movement history or duration of claim
- Analysis of claims with user defined screens
- Automatic recovery from reinsurers
- Incurred but not Reported (IBNR) causation and catastrophe recording and exception reporting
- Other routine enquiries.

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Generally the claims system provides all the facilities required to manage reserves, payments. recovery, accounting, claims history recording, statistics, various kinds of ratios, and 'run off. The claims system also provides claims experience information at the time of renewals and monitors motor claims in order to accurately manage 'no claims' bonus.

Accounting

Front Office System allows accounting for all transactions, which occur in the operating office. The accounting is generally integrated to policy management system and should automatically produce debit/credit notes, renewals notices, cover notes, reminders, statements, Bordeaux, remittance advices etc. The system should be able to handle taxes~ duties, reporting requirements as well as automatic calculation of midterm adjustments:

Statistics & MIS

The statistics module should allow production of comprehensive statistical, analytical and management information, Reports should be in any different formats and should include detailed audits, performance reports for management, should have provisions for exception reports for underwriting purposes and cumulative reports for statutory returns.

14.5.3. Life insurance applications

The Operational Offices

The Operational Office is engaged in procuring of new business and servicing of policies, Hence it has to maintain three types of data in respect of the policies being serviced by it.

Billing

Records containing policy number, name and address, installment premium etc. for printing receipts and notices.

Premium

Records containing policy number, name and address, agency code number, installment premium, commission etc. For preparing commission bills.

Valuation

Master Records containing necessary information for assessing the liability under a policy at any point of time and providing necessary statistical information to management. When, under a policy, some alterations in policy conditions are effected and the installment premium consequently gets altered! all the three files or the Policy Servicing Database have to be corrected. During mid fifties it was difficult as the only way of correcting a punched card was to punch a new card, reproducing

the unaltered information from the old card and punching only the altered information. There was always chance of errors creeping into the systems.

In order to avoid errors creeping into the system, the Insurance Industry was therefore continuously on the lookout for a system wherein the particulars pertaining to a policy can be maintained on a single record. So when the electronic computers were introduced, the Insurance lndustry was in the safeguard of its users, Since the length of a record on magnetic media can be fairly large almost all the information pertaining to a policy could be contained in single record This eliminated the problem of inter-file consistency and also simplified the process of making any alterations.

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After liberalization of insurance sector there are 29 insurers of life and general insurance and apart from Public sector undertaking all are using independent computer software keeping in their marketing strategy. The private players are controlling centrally therefore their module is quite different from the PSU's who are in the field for the more than 50 year. We are discussing in brief the module followed by Life Insurance Corporation (LIC) for the Front End Application for the branches:

- New business module (N B module).
- Cash counter module
- Policy servicing module.
- Claim module

NB Module

The NB Module takes care of premium calculation, adherence to policy terms and conditions such as minimum or maximum age at entry maximum age at maturity, policy term, sum assured, mode of payment of premium etc. The program checks the validity of individual entry and does consistency checks ag. date of birth and age, data of commencement age, term, and date of maturity, plan, mode of payment etc as expected in the policy conditions end underwriting rules, The Arithmetical part of the Underwriting process, as referred to above, having been taken care of in the Module, the underwriter is free to concentrate on other areas such as Medical Report, Moral Hazard Report. Special Report etc, thereby enhancing the quality of Underwriting Standards. Many jobs manually done previously, such as proposal review slip typing, writing of proposal register and completion advice, outstanding deposit schedule etc has been taken over by the Computer.

CASH Module

The cash module mainly caters to the needs of the cashier and some of the function of the Accounts Department. The premium receipts, policy and proposal deposit receipts, 555, Loan and interest receipts, and Miscellaneous receipts are printed through the use of the Computers. The receipts are generated on-line and there is no need to generate Special Premium receipts (as was the practice earlier). There

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is no need to keep the preprinted renewal premium receipts. The Renewal Premium history file is updated, This eliminates the ledger posting (i.e. posting of the collection of the premium in the individual ledger, which is a laborious, time consuming job). The cash book, cash and cheques collection list policy deposit schedules etc could now be printed under the CASH MODULE, thereby eliminating the manual preparation of the cash books and Outstanding Policy Deposit schedule.

Policy Service Module

This module enables recording of the Change of Address, furnishing Revival and Surrender Value quotations, Requested File Maintenance (RFM) actions, displaying Policy Deposit position, displaying premium history refunding policy deposits etc.

Claim Module

This module mechanizes all the jobs related with claims that are currently done manually starting from printing discharge voucher, data sheet to the final printing of various MIS statement.

14.6. ROLE OF INSURANCE COMPANIES IN INSURANCE SECURITY

Insurance has evolved as a process of safeguarding the interest of people from loss and uncertainty. It may be described as a social device to reduce or eliminate risk of loss to life and property.

Insurance contributes a lot to the general economic growth of the society by provides stability to the functioning of process. The insurance industries develop financial institutions and reduce uncertainties by improving financial resources.

Provide safety and security

Insurance provide financial support and reduce uncertainties in business and human life. It provides safety and security against particular event. There is always a fear of sudden loss. Insurance provides a cover against any sudden loss. For example, in case of life insurance financial assistance is provided to the family of the insured on his death. In case of other insurance security is provided against the loss due to fire, marine, accidents etc.

Generates financial resources

Insurance generate funds by collecting premium. These funds are invested in government securities and stock. These funds are gainfully employed in industrial development of a country for generating more funds and utilised for the economic development of the country. Employment opportunities are increased by big investments leading to capital formation.

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Life insurance encourages savings

Insurance does not only protect against risks and uncertainties, but also provides an investment channel too. Life insurance enables systematic savings due to payment of regular premium. Life insurance provides a mode of investment. It develops a habit of saving money by paying premium. The insured get the lump sum amount at the maturity of the contract. Thus life insurance encourages savings.

Promotes economic growth

Insurance generates significant impact on the economy by mobilizing domestic savings. Insurance turn accumulated capital into productive investments. Insurance enables to mitigate loss, financial stability and promotes trade and commerce activities those results into economic growth and development. Thus, insurance plays a crucial role in sustainable growth of an economy.

Medical support

A medical insurance considered essential in managing risk in health. Anyone can be a victim of critical illness unexpectedly. And rising medical expense is of great concern. Medical Insurance is one of the insurance policies that cater for different type of health risks. The insured gets a medical support in case of medical insurance policy.

Spreading of risk

Insurance facilitates spreading of risk from the insured to the insurer. The basic principle of insurance is to spread risk among a large number of people. A large number of persons get insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of funds of the insurer.

Source of collecting funds

Large funds are collected by the way of premium. These funds are utilised in the industrial development of a country, which accelerates the economic growth. Employment opportunities are increased by such big investments. Thus, insurance has become an important source of capital formation.

14.7. CONTOURS OF THE FUTURE OF INSURANCE IN RURAL AREAS

Insurance companies are focusing on niche segments such as travel, fidelity, workmen compensation, weather and cattle to cope with the tough business environment. Rural India has come to the rescue of insurers in the midst of a sluggish demand. At a time when the economic slowdown has taken a toll on automobile sales in urban areas, insurers have found a lifeline in semi-urban and rural areas.

Postal Agents

The post office has a regular touch with the rural people they develop an acquaintance with these people. The rural people are generally satisfied with services of post office. The Post office is the place where villagers deposit their small savings. Post office agents encourage purchasing saving instruments like Kisan Vikas Patra, Postal Life Insurance, Guarantee recurring deposit etc. The insurance companies may take the advantages of these postal agents to promote purchase of insurance policies against their small savings. The postal agents are recruited by the district saving officer, office of the collectorate and the license is issued to them for three years which is renewable. These agents may be recruited and trained by insurance companies to sell rural insurance products. The government organization such as bank and co-operative bank can play significant role to rendering insurance services in rural areas. These banks has a large database that may be utilize for the purpose of research of rural insurance market and increase sell of life insurance product in rural areas. Another important recourse is NGO that are works in various schemes in the rural areas. The NGO works very closely to the villagers and so they would be really suited for selling insurance products because they work extensively with the rural people. NGO's can also play significant role in educating villagers, providing assistant in purchase, enhancing income opportunities and promoting savings. These post office agents can work as insurance agents as well.

Government and Non-Government Organization

The government organization such as bank and co-operative bank can play significant role to rendering insurance services in rural areas. These banks has a large database that may be utilize for the purpose of research of rural insurance market and increase sell of life insurance product in rural areas. Another important recourse is NGO that are works in various schemes in the rural areas. The NGO works very closely to the villagers and so they would be really suited for selling insurance products because they work extensively with the rural people. NGO's can also play significant role in educating villagers, providing assistant in purchase, enhancing income opportunities and promoting savings.

Doctors and School Teachers

The doctor and teacher have a remarkable respect in rural areas and the image of these people is as service person. The villagers show strong trust on them. They can also work like insurance agents because villagers are ready to listen and follow them. Most of them are working as a rural agent of LIC. The private companies may use these potential for promoting sell. The Gram Pradhan, doctors, teachers, and mandi samiti are also use for the same purpose.

Unemployed Youth and Youth Clubs

The unemployed youth of village are a good resource of distribution of insurance policies. The youth club members are actively involved in welfare activities of

villagers. Some of them are part of government programs like pulse polio in spreading awareness to the rural people, this potential may be useful for educating people for benefits of life insurance. Volunteers or paid agents can be selected from youth club for marketing of rural insurance products as they are more suitable to educate and explain the benefits and need of life incurrence to the villagers.

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Check Your Progress

1. Give the meaning of term 'Reinsurance'.
2. State any three functions of reinsurance.
3. Who is a reinsurer?
4. What is meant by information technology in insurance?
5. What is Statistics & MIS?

14.8 ANSWER TO CHECK YOUR PROGRESS QUESTIONS

1. Reinsurance, commonly referred to as "insurance for insurers," is the transfer from one insurer to another of some or all of the financial consequences of certain loss exposures covered by the primary insurer's policies.
2. The reinsurance that an insurer obtains depends mainly on the constraints or problems the insurer must address to reach its goals. Although several of its uses overlap, reinsurance is a valuable tool that can perform six principal functions for primary insurers: Increase large-line capacity , Provide catastrophe protection and Stabilize loss experience
3. Reinsurers may transfer part of the liability they have accepted in reinsurance agreements to other reinsurers.
4. The devices and techniques used to store, process, manage transit and communicate information, encompass various technologies such as computing, microelectronics and telecommunication is known as Information Technology.
5. The statistics module should allow production of comprehensive statistical, analytical and management information, Reports should be in any different formats and should include detailed audits, performance reports for management, should have provisions for exception reports for underwriting purposes and cumulative reports for statutory returns.

14.9. SUMMARY

In this unit, you have learnt about the reinsurance, application of reinsurance, IT in Insurance, application of IT in insurance sector, role of insurance companies in insurance security and contours of the future of insurance in rural areas.

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As we have studied above how the IT is playing important role in insurance sector and not only this, the developments in telecommunication, have enabled networking of various computer systems. The computers have been interlinked same office through Local Area Network (LAN). As the company has many offices all over the country and to facilitate the customers, in network called Metro Area Network (MAN) is installed. Through this networking all the branches located in large cities have been interlinked. It is generally done through a central computer, which keeps the data of all the branches. This system has enabled the data for policies to be available at any branch terminal for any policy irrespective of the branch where the policy is underwritten. In this way policyholder is enable to make the payment of premium in any branch to get the receipt immediately.

As the technology is developing very fast the crime rate IT is also increasing and to protect the public interest the Govt. has implemented Indian Information Technology Act 2000 to avoid any crime in IT sector.

The life insurance companies in India are developing new products but, they fail to penetrate in rural areas where huge market lies. The penetration level of life insurance in India is very low compared to international standards and therefore has tremendous potential for growth. However, the market may be rich in potential, but new companies facing challenges. The villagers' awareness and improved distribution networks are the keys for the market enrichment. Insurer must put appropriate resource to develop the distribution network in order to grasp the potential of the rural market. The alternative distribution channels should explore by the insurance companies especially for private companies. Agents of rural market required proper training and motivated by incentives and more commission etc. In order to capture the rural insurance market, the life insurance companies must develop simple insurance product that is suitable for the rural people. Investment linked insurance product with marginal premium may be good option. The payment schedule of premium may base on suitable time of harvesting since agriculture is main source of income of rural people. To summarize The Road Map of life insurance in rural India is passes through milestones of awareness, affective distribution channels, customized products, low premium, after sale services and quick settlement of claims.

14.10 KEY WORDS

- **Reinsurance:** Reinsurance is transacted through a reinsurance agreement, which specifies the terms under which the reinsurance is provided.
- **Information Technology:** The devices and techniques used to store, process, manage transit and communicate information, encompass various technologies such as computing, microelectronics and telecommunication.
- **Claims:** The Front Office System includes an integrated claims system to record, progress and monitor claims, experience by Policy Clients brokers, Branch and risk covered.

- **Billing:** Records containing policy number, name and address, installment premium etc. for printing receipts and notices.
- **Premium:** Records containing policy number, name and address, agency code number, installment premium, commission etc. For preparing commission bills
- **Cede:** To transfer to a reinsurer all or part of the insurance or reinsurance written by an insurance company
- **Consideration:** Payment of money (premium)

14.11 FURTHER READINGS

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14.12 SELF-ASSESSMENT QUESTIONS AND EXERCISES

Short Questions

1. Give the meaning of term 'Reinsurance'
2. State any three functions of reinsurance
3. Who is a reinsurer
4. What is meant by information technology in insurance
5. What is Statistics & MIS
6. Enumerate the reasons for taking reinsurance

7. What do you understand by the term 'Retention'
8. What is Retrocession
9. Write short note on Facultative Reinsurance

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Big Questions

1. What is reinsurance? What are its Characteristics
2. What is the reasons for taking reinsurance
3. What are the functions of reinsurance
4. What are the role of insurance companies in insurance security
5. Explain the importance of IT in life insurance sector.
6. How many IT modules are being used in General Insurance Sector?
7. Is networking helpful in insurance sector?
8. Discuss the outlines of the future of insurance in rural areas
9. What are the IT application used in insurance sector